德恒律师事务所
DeHeng Law Offices

Financial and Tax Considerations in M&A Cases

Justin Fu
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Agenda

Global M&A Landscape

Global M&A Landscape in Current Economic Environment

Treatment of Losses

Treatment of Losses in Acquired Enterprises

Key Financial and Tax Issues

Key Financial and Tax Issues in M&A

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Transfer Pricing Considerations

Detailed Explanation

Detailed Explanation of Key Issues

Double Tax Treaties - Structure

Double Tax Treaties & Tax Optimization

Goodwill Accounting and Taxation

Goodwill Accounting and Taxation

Other Tax Considerations

Other Critical Tax Considerations

Global M&A Landscape (2025 Mid-Year Outlook)

01

Overall Trend

“Volume decreases, value increases” - Global deal value ↑15%, but volume ↓9%.

02

Mega-Deals Dominance

Surge in large transactions (> $10bn deals ↑19%; > $50bn deals ↑16%).

03

Regional Variations

Americas: Deal value ↑26%, accounting for 61% of global activity. Asia - Pacific: Deal value ↑14%. India's deal volume ↑18%, Japan saw large deals surge 175%. EMEA: Both deal value and volume declined by 6% - 7%.

04

Sector Highlights

Aerospace & Defense, Chemicals saw growth; Tech remained active (e.g., Google's $32bn acquisition of Wiz).

05

Key Challenges

High financing costs due to elevated interest rates. Geopolitical uncertainties and regulatory scrutiny. Pressured PE exits (47% of portfolio companies held > 5 years).

06

Cross - border Complexities

Increased focus on transfer pricing and tax treaty utilization to manage global tax burdens and avoid disputes.

Key Financial & Tax Issues in M&A - Overview

Utilization of Tax Losses

Utilization of Tax Losses from Acquired Entities

Other Transaction Taxes

Other Transaction Taxes (real estate related taxes)

Deferred Tax Considerations

Deferred Tax Considerations (e.g., in Asset Acquisitions)

Transfer Pricing

Transfer Pricing Risks & Planning

Special Tax Treatments

Application of Special Tax Treatments for Reorganizations

Double Tax Treaty

Double Tax Treaty Benefits & Limitations

Indirect Taxes

Indirect Taxes (VAT, Stamp Duty)

Post - Acquisition Integration

Post-Acquisition Integration and Tax Synergies

Goodwill: Financial Accounting

Definition

Excess of purchase price over fair value of identifiable net assets acquired.

Subsequent Measurement

Not amortized under IAS/IFRS and many GAAPs. Subject to annual impairment testing (or more frequently if indicators exist). Impairment losses are recognized in P&L.

Example

Weichai Power's goodwill primarily from acquisitions of Kion and Dematic.

Goodwill: Tax Treatment

Diverse Treatment

Tax deductibility of goodwill amortization/impairment varies significantly by jurisdiction.

Common Scenarios

Non-Deductible: Many jurisdictions do not allow tax deductions for accounting goodwill impairment. Amortization Deduction: Some jurisdictions allow tax-deductible amortization over a statutory period (e.g., 15 years in some cases).

Key Consideration

This often creates a permanent difference between accounting profit and taxable income.

Importance

Requires careful analysis of local tax laws to understand cash tax impact.

Tax Losses in Acquired Entities

Acquiring a loss-making company can provide opportunities to offset future taxable income.

Potential Benefit

Often used for tax planning and strategic positioning (gaining resources, market share).

Strategic Rationale

- Ownership Change Restrictions: Many jurisdictions (e.g., China, US) limit the use of tax losses after a significant change in ownership (e.g., >50% change in ultimate beneficial ownership).
- Historical Tax Risks: Potential inheritance of undisclosed tax liabilities.
- Integration Costs: Potential restructuring and employee placement costs.

Significant Risks & Limitations

Loss Utilization

01

General Rule

If an acquired enterprise loses its independent legal person status post - acquisition, its pre - acquisition tax losses can potentially be utilized by the acquirer, subject to limitations.

02

Strict Conditions

Business Continuity: The original business of the loss - making enterprise must typically continue. Legal Form: The acquisition structure is crucial (e.g., asset vs. share deal).

03

Crucial Advice

Professional tax advice is quite important before relying on any tax benefit from losses.

Transfer Pricing in M&A

01
Definition & Principle

Transfer pricing (TP) refers to the pricing of transactions between related enterprises. It must adhere to the Arm's Length Principle (ALP), meaning prices should be as if the entities were independent.

02
Heightened Scrutiny in M&A

Post - acquisition integration often creates or alters related - party transactions (e.g., intercompany loans, supply agreements, service fees, IP licensing). Tax authorities globally (e.g., IRS, EU) are intensely focused on TP, with significant penalties for non - compliance.

03
Common TP Risks in M&A

Recharacterization Risk: Authorities may disregard transactions lacking commercial substance. Adjustment Risk: Profit allocations may be challenged if not aligned with functions, assets, and risks (FAR analysis). Documentation Shortfalls: Failure to maintain robust TP documentation (e.g., Master File, Local File, Country - by - Country Report).

04
TP Planning Opportunities

Supply Chain Restructuring: Optimize location of functions (e.g., contract manufacturing, limited - risk distribution, principal companies) to align profits with substance. Post - Deal Integration: Design intercompany transactions with clear FAR analysis and supportable pricing methods (CUP, CPM, TNMM).

Double Tax Treaties (DTTs) & Tax Optimization / Tax Structure

Purpose of DTTs

Agreements between two countries to avoid double taxation of income earned cross - border and prevent fiscal evasion.

Key Benefits in M&A

Reduced Withholding Taxes (WHT): Lower rates on dividends, interest, and royalty payments between treaty countries. Example: China's standard 10% dividend WHT may be reduced to 5% under certain treaties if ownership thresholds are met. Capital Gains Taxation: Treaty provisions often determine taxing rights on gains from shares/asset sales, potentially exempting them in the source country if certain conditions are met (e.g., if shares are not primarily real estate - rich). Permanent Establishment (PE) Protection: Clearer rules on what constitutes a PE, helping avoid unexpected corporate tax liabilities in the target country.

Limitations & Anti - Abuse Rules

Limitation on Benefits (LOB) Clauses: Restrict treaty benefits to entities meeting specific criteria (e.g., adequate substance, ownership by residents of treaty countries). Principal Purpose Test (PPT): Denies treaty benefits if obtaining that benefit was one of the principal purposes of the arrangement (per OECD BEPS). Substance Over Form: Treaties cannot be used for mere 'treaty shopping' without real economic substance.

Strategic Use of DTTs

Holding Company Location: Selecting jurisdictions with favorable treaty networks can optimize WHT and capital gains treatment. Financing Structures: Utilizing treaty - reduced WHT on interest. Crucial: Always assess substance requirements and commercial rationale beyond just the treaty rate.

Deferred Tax Considerations in M&A

Source

Often arises in business combinations when the tax base of assets acquired/liabilities assumed differs from their fair value recognized in financial statements.

Recognition

Deferred Tax Liabilities (DTL): Often recognized for fair value upward adjustments in assets (e.g., PPE, Intangibles). Deferred Tax Assets (DTA): Recognized for deductible temporary differences (e.g., provisions) if future taxable profit is probable.

Impact

Affects the calculation of goodwill (if recognized) and post - acquisition earnings.

Special Tax Treatments for Reorganizations

General Tax Treatments

Many jurisdictions offer tax-deferred or tax-neutral treatments for qualifying reorganizations (e.g., mergers, demergers, asset contributions).

China Example (Special Tax Treatment)

Conditions often include: Reasonable business purpose (not solely for tax avoidance); Continuity of ownership interest (e.g., ≥50% consideration in equity); Continuity of business for a specified period (e.g., 12 months). Result: Eligible to defer recognizing capital gains for tax purposes immediately.

Interaction with TP & DTTs

Reorganizations often involve transfer of assets/functions; ensure TP policies are adjusted. DTTs may influence the tax outcome of cross - border reorganizations.

Other Key Tax Issues

Indirect Taxes (VAT/Business Tax)

Transfers of assets as part of a going concern are often exempt from VAT/BT in many jurisdictions (including China). Requires transfer of associated liabilities and employees in many cases.

Stamp Duty / Transfer Tax

Typically applicable to share transfers or asset transfers based on contract value. Rates and exemptions vary (e.g., exemptions possible for certain reorganizations).

Real Estate Tax

If the M&A case involves a lot of Real estates, in many jurisdictions, real estate related taxes may be triggered, which in general is a big amount.

Conclusion & Key Takeaways

Importance of Due Diligence

Thorough Due Diligence on financial, tax (including TP and DTT analysis), and legal matters is paramount.

Double Tax Treaties

Double Tax Treaties offer significant planning opportunities but are subject to anti - abuse rules and substance requirements.

Goodwill Accounting and Tax Treatment

Goodwill accounting is standardized (impairment-only), but its tax treatment varies (check local rules).

Special Tax Treatments for Reorganizations

Special tax treatments for reorganizations exist but have strict conditions.

Using Acquired Losses

Using acquired losses is highly complex and restricted; never assume availability.

Post - acquisition Integration Planning

Post - acquisition integration planning is critical for realizing anticipated synergies, including tax synergies through optimized TP and treaty structures.

Transfer Pricing Post - Deal

Transfer Pricing is a critical post - deal issue; ensure compliance with Arm's Length Principle and robust documentation.

Seeking Expert Advice

Always seek expert advice early in the transaction process to navigate these complexities.

M&A Opportunities in China

Biotech / pharmaceutical industries

China is a large market in shortage of high-end medicines and food supplements. Chinese are willing to spend for the old and children.

JV in construction / real estate industry

Chinese construction / real estate industry at low point and those companies are willing to work with foreign companies for overseas market

IT / creation industries

IT, creation and related industries are quite developed in China for past decades, and foreign collaboration is highly welcomed.

Fast consumption

China is a large consumption market. Foreign food, beverage, cooking ingredients are quite popular. Foreign textile is also quite welcomed.

Drone producers

Chinese drones may be banned in certain countries. Chinese drone producers are willing to sell components or cooperate with overseas.

Automobile, batteries

New energy auto industry is greatly encouraged and developed in China. Relevant industries, e.g. auto decoration, accessories, batteries are very active and with promised future.

Q&A

Thank You!

Justin Fu

fujj@dehenglaw.com

+86 137 6138 4404