

Big fish

The world's leading transactional firms revealed

M&A activity is, for the most part, a business-driven affair. Big fish swallow the little fish and companies consolidate their resources primarily for commercial reasons. But that is not to say tax is not a factor in decision-making. Companies will routinely look to conduct their cross-border transactions in a manner which attracts the least tax possible.

A word of caution, however. Even if companies do not conduct M&A first and foremost to avoid tax, with the global focus on base erosion and profit shifting (BEPS) ever intensifying, it is increasingly important for businesses to be able to prove substance.

The M&A market across the world has continued to pick up over the last year. New tax legislation has, by and large, not been an impediment to this recovery, however with authorities looking to shore up their tax bases and clamp down on avoidance and treaty shopping, companies will have to pay close attention to developments.

One concern is acquisition financing. A number of recent domestic reforms, particularly around Europe, have reduced taxpayers' room for manoeuvre when it comes to interest deductibility, often without a grandfathering period for long-term financing. This makes it harder to come to an informed decision about financing an acquisition.

And while solutions to problems such as these may not be clear until incoming legislation at both domestic and international level has been finalised, taxpayers already have some options at their disposal. These include tax insurance, which is increasingly being used to protect against tax risks and also to provide a source of liquidity in a transaction.

September will be a crucial month with the OECD scheduled to deliver on six of its 15 action points on BEPS.

As always, companies will need to turn to their advisers in these complex times. And once again, *International Tax Review* brings you its annual rankings of the world's top tax transactional firms.

Methodology

In January and February, *International Tax Review* asked its readers, and the tax directors of the world's leading multinational companies, to vote for their top three tax transactional firms in more than 50 jurisdictions across the world. The votes were added up to produce the survey results. No votes from advisory firms were counted and firms could not send submissions to improve their chances of being ranked. The objective was to find out if there are other firms that did not appear in our *World Tax* directory, for

whatever reason, that the market regarded highly because they had a particular specialty. Or if there were firms that appeared in *World Tax* and were known as dependable groups of tax advisers without having any star practitioners. Would they be rated for their excellence in tax transactional? This survey should be seen as complementary to *World Tax*, which looks at the whole profile of a firm, not just its size and its deal flow. This survey is more specific about a firm's advisory strengths.

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AMERICAS

Battling uncertainty to get deals done

The way that taxpayers conduct deals could be set to change, as national reforms throughout the Americas occur in tandem with processes designed to update international tax rules. **Matthew Gilleard** explores whether domestic developments in Argentina, Brazil, Peru and the US, as well as changes at international levels, will help or hinder the completion of cross-border transactions in the year ahead.

Ensuring substance, and providing evidence to support that substance, has never been more fundamental in terms of transaction work. The environment has changed. This much is clear from speaking to parties on all sides of a deal.

"Exclusively tax-driven transactions have become an extinct dinosaur," says Guillermo Teijeiro, partner and co-founder at Teijeiro & Ballone Abogados in Argentina.

This is in part down to the influence of current trends and policies aimed at increasing transparency and at countering abusive corporate behaviour that exploits mismatches or lacunae in the international fields.

Jim Fuller, partner at Fenwick & West, says transactions have always been dictated by business decisions and that tax considerations will only come into play after the business aspects have been decided.

"In our experience, M&A is always business-driven. Once the business decision has been made to acquire another company, tax considerations continue to play an important role in structuring a tax-efficient transaction and structuring for the best post-closing structure," says Fuller. "Brand and reputational issues and/or possible scrutiny by the public or authorities do not play a role at all so long as the deal makes good sense."

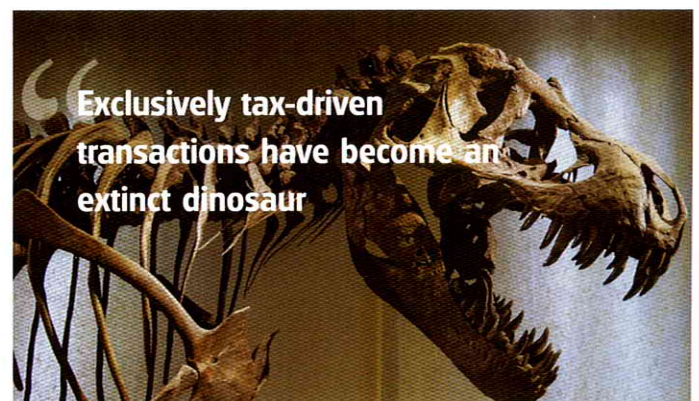
The enemy of deal-making

However, despite being business-driven, the tax considerations that come into focus during the acquisition process remain as relevant as ever. Nobody conducting a transaction will overlook the tax impact.

"Anyone who wants to make an acquisition needs to know how much it will cost and what it will earn. Both are impacted by tax considerations," says Jim Ditkoff, senior vice president, tax and finance, at Danaher Corporation. "Will the acquisition interest be

deductible? How will the target's earnings be taxed? Will it be possible to access those profits in a tax-efficient manner? And since the typical acquisition has a long payback period, it is not enough to know how these questions may be answered under current tax laws and regulations if changes are expected or likely. So uncertainty, more than anything else, is the enemy of deal-making."

Uncertainty is a word often associated with corporate taxation in Latin America; countries like Brazil have introduced more tax law amendments in the past year than most people have had hot dinners. But this label can now be slapped squarely on the US, too.



Tax reform is long overdue, and the lack of consensus both on what an improved code would look like, and on the process for getting there, is causing uncertainty to skyrocket.

One point of contention and therefore uncertainty is how to deal with extenders – those temporary provisions of the US tax code that expire (and therefore must either be renewed or repealed) every one or two years.

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US controlled foreign company (CFC) look-through rules (Section 954(c)(6)) were among the extender provisions that expired at the end of last year.

"In the US, Section 954(c)(6), the CFC look-through rules, expired at the end of last year. And while everybody expects Section 954(c)(6) to be extended retroactively, it hasn't happened yet. Some in Congress don't want to pass any extenders, including the R&E credit, which also expired, because they believe that the worse the current tax laws are, the better the prospects for comprehensive tax reform," says Dittkoff.

"Others are ok with extenders as long as there are accompanying tax increases to pay for them. But, of course, nobody can agree on what tax increases – which often disguise themselves as loop-hole-closers – are appropriate," he adds. "In the meantime, dividends of operating income and payments of interest and royalties from one operating subsidiary to another are subject to US tax whenever the payer CFC and recipient CFC are incorporated in different countries."

Dealing with Europe can be just as uncertain.

"European tax legislators are not much better," says Dittkoff. "While base erosion is a legitimate concern, no one can make an intelligent decision about financing an acquisition if legislators in Denmark, Finland, France and Sweden – to take just four examples – insist on lowering interest deductions year-after-year with no

grandfathering for long-term financing based on a good-faith understanding of the laws and rules then in effect."

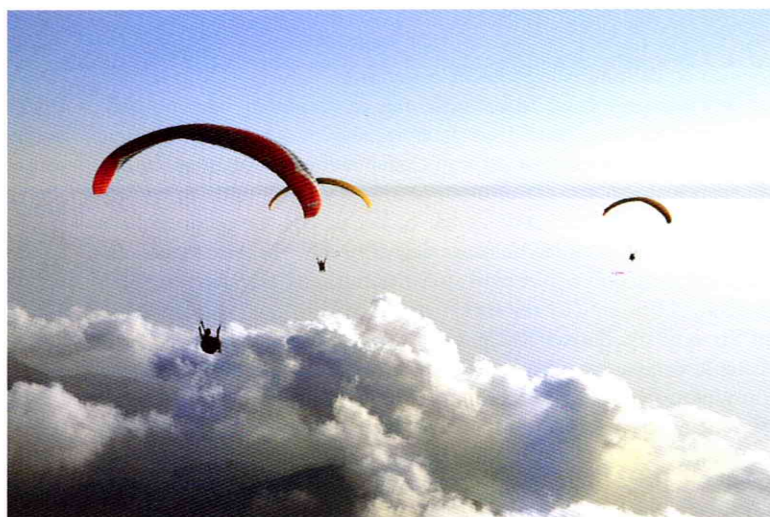
Sometimes, Dittkoff says, the tax authorities also get ahead of their legislatures.

"For example, the Swedish tax authorities attempted (unsuccessfully) to disallow deductions for interest paid to affiliates before the Riksdag got around to enacting a law to that effect. Eventually, however, the Riksdag made up for lost time by first allowing interest deductions only if the affiliated lender paid a 10% income tax – thus raising lots of tax revenue for EU tax havens, but not much for Sweden – and then enacting a law that, in some cases, taxes

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Ulhôa Canto Rezende e Guerra
Veirano Advogados

interest received from non-Swedish affiliates without allowing an offsetting deduction for interest paid to non-Swedish affiliates.”

Ditkoff says lawmakers should acknowledge the benefits of certainty by placing more emphasis on providing it for taxpayers. Consistency is key.

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“In short, acquisitions are difficult enough without adding tax uncertainties to the difficulty of projecting future trends in markets, technology, and FX. Countries that want to encourage job-creating investments ought to consider figuring out an acceptable tax regime and then sticking with it for a while.”

Thwarting the enemy

Despite the prevalence of uncertainty in the US, it does not necessarily seem to be tapering the volume of transaction work going on.

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Brazil Tax Firm of the Year, 2012, International Tax Review (Euromoney)
Brazil Transfer Pricing of the Year, 2013, International Tax Review (Euromoney)

"The tax transactional market has not changed substantially, though there seemed to have been an increased interest in international M&A," says David Forst, tax group practice leader at Fenwick & West.

"M&A was as busy as ever," adds Ron Schrottenboer, also a partner at Fenwick.

This certainly seems to be the case. Google was declared the world's biggest dealmaker by executing more deals than any company in the world over the past three years. Including acquisitions, investments and divestments, Google has been involved with 127 deals over the period, and reinforced its claim to the top spot in corporate deal-making through February's acquisition of SlickLogin, a sound authentication firm. Intel fell to third with 121 transactions, according to data from *Bloomberg*.

Comcast's \$45 billion swoop for Time Warner Cable, and Facebook's \$19 billion takeover of instant messaging provider Whatsapp (which is the social networking company's biggest ever acquisition and eclipses the \$1 billion it paid in 2012 to acquire picture-sharing platform Instagram) also showcase the acquisitional appetite of American corporates.

This thirst for expansion throws up new challenges for in-house tax teams and their external advisers, says Nancy Manzano, tax director at Vertex.

"As the pace and magnitude of global expansion (whether through organic growth or by acquisition) increases for more companies, new tax management challenges arise and in-house tax departments increasingly face unfamiliar new tax environments and statutory regimes. The growing complexity of global supply chains also poses similar tax challenges," says Manzano, who also has experience leading the tax departments of multinational Fortune 500 companies.

Helps and hindrances

In the US, the past year saw a lot of both cash and stock transactions and while each deal provides particular challenges, tax issues remained similar in 2013.

"Our advice did not change during the past year from previous years," says Forst. "It's always deal-specific and needs to fit the parties' interests. Transactions continue as they did in the past with tax issues remaining similar, though tailoring to each transaction and client can vary, as it should."

Despite the lingering uncertainty over US reform, the lack of action to overhaul the tax code has, in effect, provided a bit of stability as legislative changes are being overlooked in the assumption they will be dealt with when reform gets underway.

"US legislative rules have not changed much in recent

Tax insurance: Another tool in your transaction toolbox

Fewer private ruling given by the US tax authorities and a desire for liquidity are two of the reasons why insurance is becoming a popular protection against tax risks, explain James Gray and Alexios Hadji of Squire Sanders.

Consider this situation. A private equity buyer is negotiating the purchase of an interest in target. The acquisition structure will produce a substantial future tax benefit to the buyer in the form of amortisable goodwill. An issue arises as to whether the tax authorities will respect the acquisition structure. The buyer's tax advisers issue a "should" level opinion that the acquisition structure will be respected and the tax benefit. However, the seller will not agree to indemnify the buyer for the full amount of the tax benefit. The buyer, therefore, is reluctant to proceed with the purchase without adequate protection against the potential loss of the tax benefit. Where can the buyer get this protection and prevent the transaction from collapsing?

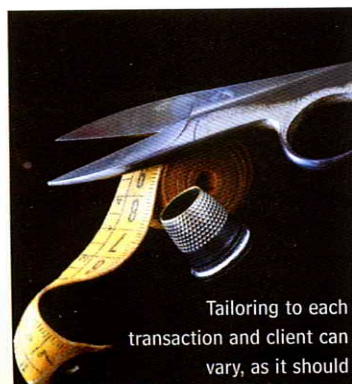
Or take the case of a large multinational corporation that wishes (or is urged by its financial advisers) to restructure its holdings along its primary business lines. The restructuring will enhance the performance and value of the separate businesses and position one of the businesses for potential divestment. The restructuring, however, involves multiples distributions of stock in corporate subsidiaries that will trigger substantial US taxes unless each of the stock distributions meets the requirements for tax-free treatment under section 355 of the Internal Revenue Code 1986, as amended. The corporation wants to protect itself against, and obtain liquidity to pay, the US taxes that will result from a failed spin-off (there will be no sales proceeds to pay the taxes). How can the corporation obtain this protection and source of liquidity?

Tax risks such as these often arise in an acquisition or restructuring (an M&A transaction). Those risks could cause the parties to abandon an otherwise advantageous transaction. In these situations, it is becoming more common in the US for the parties to purchase tax insurance, a trend that is likely to continue there and abroad.

There are many reasons parties purchase tax insurance. As noted, parties sometimes purchase tax insurance to complete transactions where neither principal party wishes to bear the risk. Instead, the risk is shifted to a third party: the insurance company.

In some cases, the parties will close a deal with knowledge of a tax risk but the buyer will escrow a portion of the purchase price until the risk is resolved. Tax insurance, however, may provide the security needed for the buyer to release the escrowed proceeds immediately. Thus, not only can tax insurance protect against tax risks, it can also act as a source of liquidity in a deal – in this case by allowing escrowed proceeds to be released immediately (or by eliminating the escrow altogether). It can also be a source of liquidity in transactions where there are no sales proceeds, by giving the taxpayer a source of funds other than operating profits to pay the taxes.

James Gray is a partner, and Alexios Hadji is an associate, at Squire Sanders. They explore the issue of tax insurance in a longer piece published with *International Tax Review* in February.



Tailoring to each transaction and client can vary, as it should

years, at least not since 2010," says Fenwick's Adam Halpern, who adds that US legislative rules generally assist with M&A, while some IRS administrative changes have also helped.

"Some IRS administrative changes are on the negative side of the ledger, however, such as putting spin-offs in the no-rule area, denying 336(c) treatment (a domestic stock acquisition electively can be treated as an asset acquisition) for international acquisitions, and the recent administrative changes regarding inversions," says

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Halpern. “US legislative rules regarding joint ventures can be a hindrance.”

However, despite a relative period of calm in terms of legislative rule changes, the Treasury’s new anti-inversion regulations referred to by Halpern will be sure to impact transactions in 2014.

“Treasury and the IRS are so paranoid about inversion that they’ve tightened the rules further yet and, in doing so, have greatly exceeded the statutory rules and their statutory authority,” says Schrottenboer. “These changes must be considered in many transactions, even those that are not inversions, to make sure they do not accidentally fall foul of the rules.”

Case law stemming from tax disputes also have the potential to help or hinder transactional work and there are some pending cases in the US Tax Court in which the IRS is seeking to expand the definition of intangibles to have goodwill, going concern value and workforce in place treated as intangibles under 376(d) even though the statute clearly does not do so.

“This could affect international transactions,” says Fuller.

Authority action driving taxpayer conduct

The events of 2013 highlighted how reputational issues have risen up the agenda when it comes to corporate taxation. This is particularly the case in the US and Europe, as the tax teams of Amazon, Google and Starbucks will testify to in the UK, and those of Apple and Google will confirm in the US.

In Latin America, however, while brand image concerns are a factor, Teijeiro says the pervasive action of tax agencies is still much more significant in determining taxpayers’ conduct than reputational issues or pressure from the public.

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Ramon Esquivés Espinosa, head of tax processes in the management and tax advisory unit of BBVA’s finance area, says the situation further north in Peru tells a similar story. He does, however, place greater emphasis on reputational issues, but this is more likely to be a reflection of the financial services sector he operates in rather than a jurisdiction-specific factor.

“Due to the necessity to increase the tax collection from our government, the tax authority has increased its audits and in some cases arguably without adequately supporting their tax calculation. In that scenario, tax issues are one of the most important factors in deal-making for the amount of contingencies and brand reputational issues,” says Esquivés.

In Argentina, Teijeiro says, genuine M&A activity is scarce because of macroeconomic conditions and government policies and attitudes towards businesses.

For a variety of reasons, the transactional market in Argentina has been stagnant for the past three years and transactions have mostly been domestic. Multinationals that already have a presence in Argentina (for example a subsidiary) and surpluses blocked within the country because of strict foreign exchange restrictions, use available funds to acquire competitors and consolidate a presence geared toward the domestic market, or to diversify acquiring export-oriented lines of business.

“This increases export yields to be used to compensate payment of imports (for example for services, raw materials or other compo-

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nents used in the final products sold) within the framework of applicable foreign exchange restrictions,” says Teijeiro. “Aside from that move and similar transactions among insiders (Argentine-owned businesses changing hands locally), I observe no new overseas players coming into the market. Some activity is also originated by Argentine businesses that, as in previous years, keep acquiring agricultural land and agribusiness in other countries in the region (mostly Uruguay and Paraguay) which, unlike Argentina, apply no export duties on soybeans and grains.”

Teijeiro says the government’s economic policies, including an internal market-oriented, highly regulated and subsidised economy, financed by huge cash surpluses coming from commodities exports, as well as the restatisation of private companies and the associated expropriation risks (for example, the still-not-settled *Repsol* case) have functioned as a deterrent for new foreign direct investment (FDI) into Argentina.

“Day-after regulations on business activities also conspire against new FDI coming into the country,” he says. “Tight foreign exchange control regulations are impeding or making burdensome the payment of obligations to foreign licensors or creditors, or even distributing dividends to a foreign controlling shareholder are killing aspects even to niches that might potentially attract foreign investors at large.”

These are not the only policies Teijeiro cites as negatively affecting transactional activity. Others include shale oil and gas exploitation – a special regime created last year to associate with YPF to explore and exploit the Vaca Muerta region appears not to have been sufficient to attract the world’s oil leaders with investments commensurate to the reservoirs, beyond Chevron (the first direct beneficiary of the regime working effectively in the area, Sinopec (owner of Pan-American Energy, a local oil company), Total, Wintershall and Dow, which also have commitments in the area.

But, above all, the worsening foreign exchange restrictions are the biggest barrier to transactional work.

“Since most obstacles come from foreign exchange restrictions currently in force, cross-border payments make transactional work troublesome.”

As a result, M&A transactions on a local target executed outside Argentina between a foreign seller and a foreign purchaser are favoured because of the lack of significant legal and tax obstacles.

“Acquisitions are difficult enough without adding tax uncertainties to the difficulty of projecting future trends in markets, technology, and FX

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Two important developments impacting transaction work in Argentina are the new income tax amendments passed by Congress in late September 2013, taxing capital gains arising from the sale of shares, bonds and securities obtained by individuals and foreign entities, as well as the taxation of cash and in-kind distributions (dividends) or PE remittances, which were non-taxable under prior law. The effective rate on capital gains on foreign beneficiaries is 13.5% (15% on a presumed net income basis equal to 90% of the gross amount) or, alternatively, the 15% statutory rate on the actual net taxable gain obtained. Dividends and PE remittances are taxed at 10%.

“Unlike our neighbours Brazil, Chile and Peru, the new tax on capital gains does not apply on indirect holdings (for example, a Vodafone-type taxation) so planning is still possible to avoid the impact of the tax upon divestment,” explains Teijeiro. “Regarding capital gains taxation, specific exemptions for particular types of securities remain available, namely on publicly traded negotiable obligations (corporate bonds issued in series) and financial trust debt or equity securities.”

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The tax transactional landscape in Argentina is not expected to change until the macroeconomic environment and perception of business change. If that does occur, transactional activity could rise sharply and rapidly.

In Peru, Esquivés says the typical transactions going on include mechanisms to invest in real property and construction, as well as intercompany transactions such as loans and back-office services. His main advice for other taxpayers is to be thorough when compiling information to support the transaction from the moment of its inception.

"I am advising that taxpayers must collect more support for their transactions from day one," he says. "In this sense I have to do advisory and audit work."

He lists challenges including getting support from staff within the company about transactions with tax risks.

"In this sense I have to be close to the areas involved in those transactions and their managers," says Esquivés, who observes the trend that getting deals done is taking more time than in previous years.

"We need to invest more hours and staff [to get deals done]," he says.

For the year ahead, Esquivés says developments concerning the reform of international tax rules and international tax transparency regulation will be among the most significant factors affecting transactional work.

"But above all, be aware of the importance of supporting transactions to prove the reality of the transaction and the market price," he adds.

OECD delivery

Irrespective of where in the Americas you are, taxpayers and their advisers will be keeping a keen eye on the progress being made by the OECD to reform international tax rules. A watershed moment will arrive come September, when six of the organisation's 15 BEPS action points are scheduled for completion. The degree of success the OECD has in delivering on its schedule will likely determine the extent to which countries continue to engage. Failure to meet its stated objectives in the timeframe imposed could cause jurisdictions to look towards unilateral action, and myriad domestic reforms will almost certainly make cross-border transaction work more difficult.

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