Developments in negotiating Tax clauses in a SPA – Netherlands

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INTRODUCTION

A successful M&A transaction requires carefully drafted Tax clauses in the share purchase agreement ("SPA"). In this article we highlight a selection of relevant developments in negotiating Tax clauses in a SPA when acquiring a Dutch taxpaying entity.

W&I INSURANCE

The rise of W&I coverage for historic tax liabilities over the past years has impacted the focus in SPA negotiations. Although usually a full scope SPA including Tax Schedule is signed, the seller's liability for potential tax claims is capped to EUR 1 and recourse of the buyer for unknown historic tax liabilities is set towards the insurer.

Generally additional W&I coverage is possible for remote or low tax risks identified during due diligence. However medium and high risks, as well as certain specific topics (such as transfer pricing or real estate transfer tax), can only be mitigated through a purchase price reduction, specific tax insurance or a specific tax indemnity in the SPA (although the latter is rare as it goes against the commercial rational of the W&I insurance to achieve a 'clean exit').

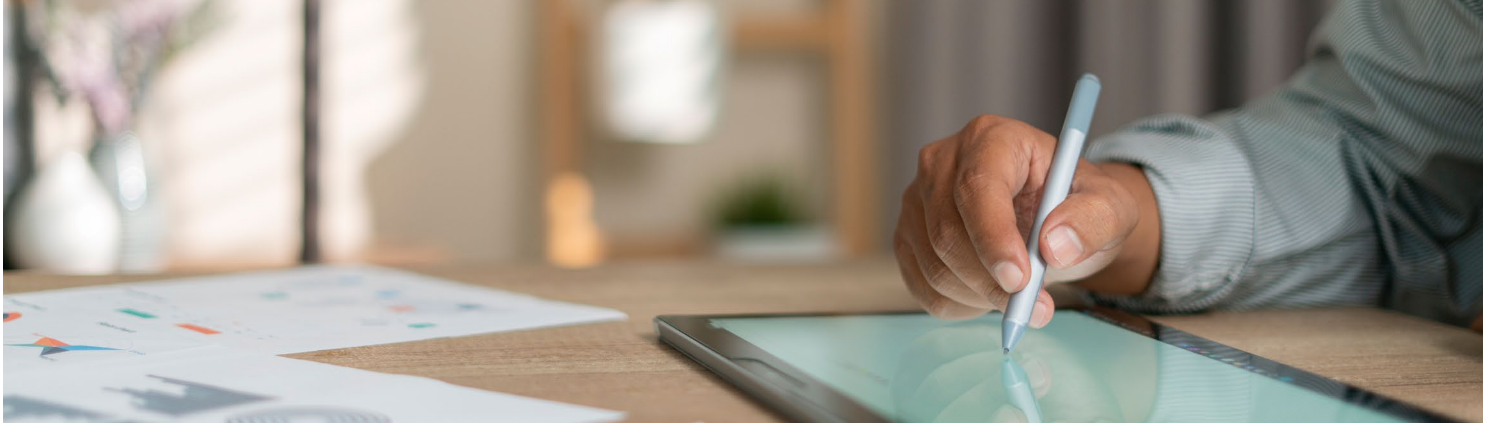
The tax due diligence practice has adapted to fit the W&I insurance requirements. W&I oriented scoping for tax due diligence procedures and access to relevant information between sell-side and buy-side teams results in broader coverage of any potential issues. Risks identified should however be carefully qualified and quantified in order to describe the relevance in the due diligence reporting. A general reference to obtaining contractual protection to risks identified (or not have been able to exclude due to the lack of information) is not sufficient for W&I purposes.

The negotiations of the tax indemnity and tax warranties in the SPA with W&I coverage is mostly focused on aligning the scope of the SPA and the envisaged W&I insurance. In W&I backed transactions, the following tax clauses of the SPA are furthermore often debated on:

- The conduct of tax affairs clauses depict the rights and obligations of both parties in the case of a potential tax claim. In the case the seller's liability is capped at EUR 1, parties often agree that the buyer has sole conduct of potential claims (allowing to align with the requirements under the W&I insurance). As these clauses are however very flexible and can accommodate arguments of both sides, various alternatives are available.

  For example, in the context of historical tax grouping, the seller's position can also be impacted, or in case of Horizontal Monitoring being applied by a taxpayer, where the relationship with tax authorities may be adversely affected, the seller can be involved in managing the potential tax claim.
- Overprovision and refund clauses: in line with the rational to have a clean exit after a transaction, in international W&I backed transactions overprovision or tax refunds after closing may not be addressed. In a response, the due diligence workstreams adjust by putting more emphasis on the current tax position per the effective date. However, from a sell-side perspective, such clauses allow to directly increase the purchase price in the case of a positive adjustments of the tax liabilities (outside the scope of the W&I). In practice this results in balanced wording of the SPA in terms of the actual cash impact and responsibilities of parties involved.
- Furthermore, in various situations under Dutch tax law, compliance actions by sell-side are required to lock in the utilization of tax assets (e.g. for carry forward tax losses or interest) or to manage the deconsolidation date of the fiscal unity. The Tax Deed should address those matters, regardless of whether W&I is obtained.

> The rise of W&I coverage for historic tax liabilities over the past years has impacted the focus in SPA negotiations and discussions extend beyond the tax indemnity or tax warranties.



DEFINITION OF TAX

The SPA should include a definition of Tax to define the scope of the Tax clauses and, Tax Deed and allocates compliance obligations between parties. Usually, the SPA includes a very broad definition by referring to all forms of taxation or contribution, including penalties or charges, that are payable to a Tax Authority, whereby several examples are given. Negotiations often arise on whether the definition should also include Tax due (i) under secondary liability, (ii) payable under a contract or (iii) payable as recovery of State Aid.

In the past years, several new taxes have been introduced worldwide, such as the introduction of Pillar II Minimum Taxation (see below) and a wide range of environmental taxes including for example carbon taxes, CBAM and energy taxes such as the Inframarginal Levy. Such new taxes may not necessarily fall under the scope of the standard definition of Taxes in the SPA and should be specifically reflected when applicable, to mitigate any disputes between parties on the coverage of the SPA and W&I.

PILLAR II MINIMUM TAXATION

The before mentioned Pillar II Minimum Taxation is a result of the OECD Framework for minimum taxation and is implemented in the Netherlands under the Minimum Tax Rate Act (*Wet Minimumbelasting 2024*). Under Pillar II, multinational groups with an annual revenue of at least EUR 750m are subject to a minimum profit tax of 15% in the jurisdictions where the effective tax rate was initially lower.

The Pillar II rules include not only the minimum profit tax but introduce a new set of tax compliance obligations (e.g. the top-up tax information return) and significant potential penalties and secondary liabilities for multinational groups in the case of non-compliance. As a result the Pillar II Minimum Taxation inter alia affects the following clauses:

- **Definition of Tax** – aligning with the potential coverage of the W&I.
- **Tax warranties and indemnity** – to address specific findings in due diligence on historic compliance and tainted transactions, protection against potential secondary liabilities.
- **Conduct of Tax Affairs** – The SPA should address the complications around a carve-out of a multinational group in terms of financial consolidation, tax payments, compliance and exchange of information between parties.

DECONSOLIDATION DATE FOR CIT GROUPING

Dutch tax paying entities are often included in a tax group (fiscal unity) for CIT purposes and the SPA should accommodate for the deconsolidation in case of a carve-out of the target group from a larger fiscal unity.

Under the CIT fiscal unity regime, the group files one consolidated CIT return and the top shareholder of the group is the designated tax payer (a secondary CIT liability applies the group companies). The designated tax payer therefore pays the CIT to the Tax Authorities for the tax period until the fiscal unity ends and a settlement with the target group should take place.

In M&A transactions, the date with which the fiscal unity ends (Deconsolidation Date) is not necessarily in line with the Effective Date of the transaction (especially in Locked Box transactions). Depending on the purchase price mechanism and specific clauses of the SPA, the conditions for the fiscal unity regime (95% economic and legal ownership of the shares) may no longer be met at signing, closing or the moment the conditions precedent are met.

In practice, parties often wish to achieve for practical and/or tax structuring reasons that the deconsolidation date is the closing date and file a specific request with the Dutch Tax Authorities for confirmation. However, as the policy around the deconsolidation date includes four specific conditions for such request (one being that closing is subject to regulatory approval), such approval is not always necessarily feasible.

In light of the above, the Tax Schedule of the SPA should specifically include wording for the CIT settlement for the period after the effective date as well as wording on the envisaged deconsolidation date, including necessary actions in case the Tax Authorities do not agree.

EXIT TAXATION AFTER DECONSOLIDATION CIT FISCAL UNITY

The deconsolidation of the CIT fiscal unity may trigger an exit taxation at the level of the CIT fiscal unity in case of historic intercompany transactions whereby hidden reserves were transferred. A deconsolidation triggers that such assets are valued at fair market value, resulting in a deemed profit only for tax purposes and a CIT cash out payable by the designated taxpayer (seller). The target entity that owns the assets however receives a step-up in valuation to the fair market value and may claim additional depreciation for tax purposes post-closing.

In M&A transactions that trigger a deconsolidation, it may be reasonable to include wording in the SPA that accommodates for a compensation to be payable by the buyer to the seller in the event such exit taxation arises and a step-up is secured (regardless of whether this was identified during due diligence).

The actual cash benefit of such additional depreciation depends however on the CIT position of the target post-closing and a buyer may not be willing to agree to such compensation in the case the target group is not expected to be in a CIT paying position.

Negotiations of the wording of the SPA furthermore arise on the calculation of the compensation, at nominal or discounted value (minding the depreciation schedule of the step-up and tax rate applicable) and responsibilities of both parties to secure the actual step-up.

HOW CAN A&M ASSIST?

A&M's tax practice in the Netherlands has a dedicated Transaction Support team that assists in drafting and negotiating tax clauses in Transaction Documentation.

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