Research on Tax Risks in Corporate Mergers and Acquisitions - An Example of the Process of Huaxing Yuanchuang's Acquisition of Oulitong

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Abstract. The rapid development of the global economy has made mergers and acquisitions a powerful tool for companies to expand rapidly, acquire fresh assets quickly, and enter new fields. With China's socialist market economy becoming increasingly sophisticated and the financial market full of vitality, domestic enterprises are increasingly turning their attention to mergers and acquisitions. However, while M&A brings a lot of convenience to enterprises, it also carries a lot of risks. If not handled properly, not only will the M&A fail to materialize, but it will affect the business operations of the enterprise. Tax risk is becoming more and more prominent, yet domestic research on it is not perfect, so it is necessary to form a tax risk management system for M&A. This article examines the tax risks of Huaxing Yuanchuang's M&A of Aliton and puts forward management recommendations. Ariton, management recommendations for each stage of the M&A process are presented.

Keywords: Mergers and acquisitions · Tax risk · Risk management

1 Introduction

In recent years, China's M&A deal market has grown rapidly, with 159 M&A deals disclosed by A-share listed companies in 2022, with the total value of actively disclosed M&A deals totaling approximately RMB 491.6 billion, an increase of 27% over the previous year. George Stigler has noted that the growth of large companies often relies on internal expansion rather than external acquisitions. However, the failure rate of M&A in China has exceeded 80%, suggesting that this model of growth is riskier. As a result of the changing and expanding nature of M&A, the complexity of M&A transactions, and the large number and asymmetry of information, more and more issues have come to light and China's tax policies are changing to regulate the multiple taxes involved in M&A transactions. For M&A transactions, the appropriate resolution of tax-related issues will have a significant impact on the success and viability of the overall transaction. Therefore, it is important for companies to be fully aware of this important issue and to enhance the management of M&A tax risks in order to achieve optimal results. It

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2 Literature Review

2.1 Review of Foreign Literature

According to Ngeuywn Giong (2020), mergers and acquisitions (M&A) is an important form of capital management for companies, including both mergers and acquisitions, in which both parties exchange and acquire assets and ownership on a voluntary and equal basis to achieve the company's development goals. Mergers and acquisitions can be divided into three types: asset exchanges, mergers, and equity transfers [1]. According to Armstrong and Chris (2018), companies that do not fully comply with the latest tax regulations in their day-to-day business activities are at risk of increased tax costs, which may have a negative impact on their growth [2]. According to Tina Wang (2019), mergers and acquisitions can not only capture markets and raise awareness but can also generate economies of scale. However, as the tax risks associated with M&A vary across industries and target companies, companies should familiarise themselves with the different tax regulations of each country when conducting cross-border transactions [3]. According to Ernesto Crivelli (2019), real estate companies may face tax risks in the course of M&A. Li Xiu-hua (2011) points out that adopting a more scientific and rational tax planning scheme will not only help the smooth implementation of mergers and acquisitions but also effectively contribute to the long-term development and prosperity of the company [4]. The use of more scientific and reasonable tax planning solutions not only helps the successful implementation of mergers and acquisitions but also effectively promotes the long-term development and prosperity of enterprises [5]. According to Emst (2004), in order to reduce the tax burden of mergers and acquisitions, the focus should be on the tax aspects of mergers and acquisitions, which should be taken into account in the internal audit process to ensure that the tax risks are controlled [6]. According to Donald Nicolaisen (2013), tax risk management in M&A restructuring requires taking full advantage of M&A incentives and adopting effective financial measures to reduce M&A costs [7]. Financial measures to achieve the dual objectives of reducing M&A costs and enhancing corporate value.

2.2 Review of Chinese Literature

Chen Jinhui (2004) introduced the concept of "tax risk management" for the first time in Chinese literature and conducted an in-depth study on e-commerce risk management [8]. Wang Yanli (2011) points out that tax risks can be attributed to two aspects: on the one hand, due to the lack of effective tax planning ability of enterprises, and on the other hand, due to the backward development of China's tax system and the failure of enterprises to comply with relevant tax policies and regulations in a timely manner, which leads to mistakes in practice [9]. Gu Zhaochun (2011) points out that tax risk management should be integrated into the daily risk management of enterprises, and that tax risk management should be included in the internal control procedures of enterprises [10].

Gao Jinping (2020) emphasizes that tax risk control is not only an important part of business management but must also be considered as a global consideration for business development [11]. Chen Yi (2021) suggests that in order to effectively prevent and respond to tax risks, enterprises should take effective measures, including improving internal control mechanisms, promoting the development of information technology, and recruiting professional talents [12].

3 Research Methodology

Literature analysis method. Through an in-depth study of the literature on M&A restructuring and tax risk management and a comprehensive examination of the research results of various scholars, an in-depth insight into the tax risk management of corporate M&A was gained and lessons learned, laying a good theoretical foundation for this study. Case analysis method. Through the acquisition of Ou Litong by Huaxing Yuanchuang, we collected information about the company's annual statements and announcements from Juchao Information Website, the company's official website, and various other financial media. Based on this, we discussed in depth the tax risks in the acquisition process and finally came up with a series of recommendations to help tax risk management.

4 Mergers and Acquisitions Carry Tax Risks

4.1 Pre-merger Tax Risk

Tax risk is a potential financial issue that can expose a company to significant losses. These risks may arise from the location of the company, due diligence, changes in tax incentives, or other factors. Companies should therefore take these issues seriously and take effective measures to avoid these risks.

Tax Risks of Target Selection

Before making an acquisition decision, it is important to identify the target company and ensure that it complies with the laws and regulations before making a thorough assessment to determine the best acquisition option in order to achieve the best possible return. The information in Oriton's annual report shows that Oriton is a husband-and-wife business model and has borrowed from related parties on several occasions, with related transactions amounting to more than RMB 19 million, making Oriton's compliance questionable and possibly subject to historical tax risks. The corporate income tax rate for 2017–2019 is significantly higher than 2%, while the tax rates in November were 7.68%, 11. 17% and 5.49% respectively, which indicates that the tax authorities may take measures to interview enterprises to ensure that their legitimate rights and interests are effectively protected. Through the Tax Assessment Management Measures, we can determine whether Oerlikon has historical tax risks by examining its key financial data, such as the rate of change in its main business.

Oerlikon's financial reports for 2018 and 2019 show that the rate of change in operating revenue far exceeds the rate of change in operating costs, with the rate of change of 1.3 being higher than 2.99, which indicates that the change in operating revenue far exceeds the change in operating costs. In addition, the Company's operating income in 2018 varied at a much higher rate than its operating expenses, resulting in a decrease in expenses and an increase in revenue in 2019. It is possible that Oerlikon may have underestimated costs and expenses or inflated revenues. As a result, if the change in operating income is smaller than the change in operating profit and the matching ratio is less than 1 in both 2018 and 2019, there is a higher probability that Oerlikon will incur the financial risk of undercharging costs and expenses. In addition, the decrease in asset margin and total asset turnover ratio and the increase in sales margin in 2019 may be due to the Company's concealment of sales revenue, which poses certain tax risks. According to the valuation management approach, if inventory increases at a slower rate, or even decreases compared to last year, while total asset turnover also decreases significantly, this means that the company may conceal the true state of sales revenue. 2019 saw a significant decline in both Oerlikon's inventory volume and total asset liquidity, which could result in a reduction in the company's revenue.

Risk of Tax Due Diligence

Due diligence is crucial for corporate acquisitions and mergers, as it helps us to gain a comprehensive understanding of the target company's financial position, assets, liabilities, legal relationships, etc. so that we can identify potential business opportunities and risks, and thus develop effective response strategies to ensure the successful implementation of the acquisition. In the M&A process between Huaxing Yuanchuang and Oriton, Huatai United Securities Co., Ltd. Acted as an independent financial advisor rather than taking other accounting firms or taxation firms into consideration. According to the report of Huatai Securities' independent financial advisor, the company did not conduct a comprehensive assessment of Ou Litong's tax due diligence, covering various areas such as the implementation of internal controls, application of tax policies and preferences, daily tax returns, acceptance of inspections by tax authorities, production and operation, material assets, investment, and financing. In addition, the company did not conduct a comprehensive review of Oliton's tax advisors, recent tax authority examination reports, and tax return documentation. Neglecting these issues will lead the company to overlook the historical tax risks of the acquired companies, creating tax compliance problems for the post-merger companies, which in serious cases will lead to the failure of the merger or even cause Huaxing Yuanchuang to trigger the delisting risk of the KRC.

Risk of Changes in Tax Incentives

The registered office of both Huaxing Yuanchuang and Ou Litong is in Jiangsu, which does not involve cross-regional mergers and acquisitions. Therefore, there will be no significant changes in the tax items and tax procedures of both parties to the merger and acquisition, which is conducive to the assessment of relevant tax risks. According to the policy of the State Administration of Taxation (2009) No. 203, eligible high-tech enterprises will be granted a low tax rate of 15%. Both Huaxing Yuanchuang and Ou Litong have passed the review, and Ou Litong's R&D investment ratio even surpassed that of Company A and even surpassed that of Huaxing Yuanchuang in 2017, which not only reflects the high-tech features of the Science and Technology Board but also provides more opportunities for the integrated company, thus reducing its This reflects the high-tech features of the KCI Board and also provides more opportunities for the consolidated companies, thus reducing the risk that they will not continue to enjoy such preferential tax rates. In this way, we can significantly reduce the future tax burden.

5 Inspiration and Suggestions for M&A Tax Risk Management

The tax risks of Huaxing Yuanchuang's M&A of Ou Litong have been sorted out above according to the pre-term phases of the M&A. In the following, we will propose methods to prevent these tax risks and establish a comprehensive and scientific M&A tax risk management system, so as to provide lessons for other enterprises conducting M&A. This will serve as a reference for other enterprises in the M&A process.

5.1 Pre-merger Tax Risk Prevention

Selecting a Suitable M&A Target
The target M&A company must meet the requirements of relevant laws and regulations, and synergies should be fully considered to ensure that both parties are in the same industry or in an upstream or downstream environment to achieve the best allocation of resources. As M&A occurs in the same industry, the production, operations, and marketing activities of both companies must be coordinated to cope with the increased reliance on end customers and the competition that may arise as a result of increased business concentration. Upstream and downstream mergers and acquisitions may involve both parties in multiple industries, creating a diverse tax burden, but the existence of a good cooperative relationship between them reduces the tax risk due to information asymmetry. Given the range of incentives offered by the state, such as reduced tax rates, reduced tax liabilities, and extended tax periods, these companies may be able to benefit from tax incentives if they are targeted for acquisition. In conclusion, the acquirer should follow prudent, objective, and scientific guidelines and conduct a comprehensive and in-depth study of the acquired company to maximize the advantages of both parties and thus enhance the overall competitiveness of the company.

Conducting Tax Due Diligence
To minimize the tax risks associated with an M&A or investment, it is common for the acquirer to hire a professional organization to conduct tax due diligence. These investigations will help ensure the legitimacy and sustainability of the M&A activity. Due diligence is a comprehensive, in-depth, and holistic tax investigation that helps companies to identify not only past tax risks but also potential future tax threats, thus providing them with comprehensive, accurate, and effective tax management. It covers a much wider range of information than traditional tax professional services and can gather a wide range of relevant information to help companies gain a better understanding of their situation. Before conducting tax due diligence, a thorough tax review of the acquired company should be carried out to predict its legitimacy, decide whether to accept the acquisition or increase protection measures and effectively prevent tax risks. It is also important to gain insight into the actual state of the acquirer's operations

to provide direction for future tax strategies. Tax due diligence is conducted with the following objectives in mind: to gain an in-depth understanding of the financial risks posed by an investee company's failure to pay taxes on time, and to scrutinize the accuracy and completeness of the company's financial reports, as well as the existence of tax evasion, false records and other violations of the law; through in-depth investigation and analysis, we will gain a comprehensive understanding of the target company's, we will gain a comprehensive understanding of the relevant tax information of the target company, including tax-related matters, invalid tax benefits, and significant connected transactions. Through in-depth investigation and analysis, we will gain a comprehensive understanding of the relevant tax information of the target company, After thorough tax due diligence, we have identified the potential tax issues of the target company and we incorporate this information into the M&A negotiations so that both parties are aware of the tax risks associated with the M&A. By entering into an M&A agreement, the tax burden can be effectively mitigated or offset, thereby reducing the tax implications of the acquisition. This reduces the likelihood of a failed acquisition due to tax issues.

Using Policy to Choose the Right M&A Approach

In an M&A transaction, both the transaction method and the financing method can have a significant impact on the tax implications of the M&A. Therefore, companies should choose the transaction and financing method reasonably and scientifically to reduce the tax risk to a manageable extent. Subject to certain tax conditions, a transaction may be carried out provided that the business purpose of the acquirer is reasonable and is not to reduce, exempt, or defer tax; in the case of an acquisition, merger, or demerger, the proportion of assets or equity should be at least 50% and the proportion of equity payments should be at least 85%; the business situation of the company will continue to be stable and unaffected for 12 months after the completion of the reorganization After the completion of the restructuring, the former major shareholders must maintain their existing control and must not sell their shares to any third party within the next 12 months. This can effectively reduce the company's tax burden and also make use of the time value of money to effectively control cash flow, thus effectively improving the efficiency of the company's operations. This can effectively reduce the tax burden of the enterprise and also make use of the time value of money to effectively control cash flow, thus effectively improving the operational efficiency of the enterprise and ultimately contributing to the success of the M&A.

6 Conclusion

As the global economy continues to integrate, many companies are growing and improving. Through mergers and acquisitions, these companies can increase their competitiveness, expand their market share, achieve exceptional growth and accelerate their elimination. Tax risk in M&A is an important risk that determines to a certain extent the success of M&A and is also closely related to the efficiency of M&A. This article takes the 2019 M&A of Oriton by Huaxing Yuanchuang as an example and finds that tax risks exist at all stages of M&A. In the early stage of M&A, the risks mainly lie in the selection of M&A targets, tax due diligence, and changes in tax policies. Enterprises should select

M&A enterprises scientifically according to their development strategies and policies, conduct pre-merger tax investigations and grasp their tax-related information in detail. In the mid-term of M&A, the choice of M&A pricing, payment methods, and financing methods will affect the tax risk of the enterprise. Tax professionals should be dispatched to join the M&A negotiations, analyze the M&A tax issues from a professional perspective, and incorporate the relevant provisions into the M&A agreement to prevent the occurrence of risks and protect the economic interests and normal operation of the enterprise. After the completion of the M&A, enterprises will face tax risks arising from financial integration, impairment of goodwill and compensation for performance commitments, etc. In this regard, enterprises can promote the integration of the two sides and maximize the synergy effect by unifying strategic objectives and financial indicators and dispatching financial personnel. In this regard, enterprises can promote the integration of the two parties by unifying strategic objectives and financial indicators and dispatching financial personnel to promote the maximization of synergy effects, and at the same time establish a special tax risk management department to deal with tax-related issues in all aspects, formulate tax strategies suitable for the development of enterprises and improve tax compliance.

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