MODULE 10

MERGERS AND ACQUISITIONS

OUTLINES

- Definitions
- Reasons for Mergers and Acquisitions
- Tax complications

Definitions

- **Merger**

  A merger is an arrangement in which the assets, liabilities and business of two companies are vested in and carried on by one company, which may not be one of the merging companies and under a situation in which the new company is owned by the owners of the merging companies.

  A merger can be done in such a way that one of the merging companies absorbs or acquires the other companies so that while the other companies are liquidated, the acquirer continues to exist. In the merger of United Bank for Africa Plc and the Standard Trust Bank Plc in 2005, the latter bank lost its identity and went out of existence. United Bank for Africa continues to exist. A merger may result in the formation of a new company, to which the shareholders of the old companies exchange their equity shares for the equity shares of the new company. The old companies will cease to exist.

  A horizontal merger is a merger involving companies in the same line of business (producing similar goods or providing similar services. For example, the merger of Eastern Breweries Plc and Continental Breweries Ltd to form Consolidated Breweries Plc and also the merger between Stanbic Bank Ltd and IBTC Chartered Bank Plc to form a new entity known as Stanbic IBTC Bank Plc.

A vertical merger involves companies which are in different lines of business.

In other words, the merger takes place between companies producing different goods or services. It may be forward or backward. For example, a tyre manufacturing company merging with a rubber plantation company.

- **Acquisition**

Acquisition usually involves the purchase of all or majorly of the equity shares of one or more companies by another company. For example, if A Ltd acquires more than 50% of B Ltd and C Ltd's ordinary shares, B Ltd and C Ltd are subsidiary companies of A Ltd, while A Ltd is regarded as the and parent or holding company.

All the three companies will continue to exist as separate legal entities after the acquisition, but the holding company will exercise control over the subsidiary companies.

Under merger, the shares of the new or surviving company are usually issued to all or almost all of the shareholders of the old companies in exchange for their shares acquired.

Under acquisition, the shareholders of the companies acquired are mostly settled in cash.

Reasons for Mergers and Acquisitions

a. Diversification and risk reduction

When there is merger of companies which are in different lines of trade, it may be possible for the merged entity to spread risks. In other words, the conglomerate is hedged against the impacts of a downturn or cyclical instability in earnings in an individual industry.

b. Operational economies

When two or more companies merged, it may be possible to eliminate duplicate facilities and consolidate some operations or functions such as purchasing, marketing, accounting, research and development, data processing, etc. For example, the company can have on centralized purchasing department instead of two.

c. Financing

A company which has surplus can spend it in several ways, for example, pay extra dividends, embark on internal expansion, acquired another company, etc. The shareholders will have to pay more tax if more dividends are paid to them. The company may limited internal opportunities in which to invest the surplus cash. A cash-rich company may, therefore, utilize it excess cash to acquire another company.

In the other hand, a company which short of cash may find it difficult to growth through internal development. However, such company may be able to grow externally through acquisition of another by issuing its shares to the shareholders of that company as purchase consideration.

d) Growth

Due to some constraints a company may find tie difficult to grow or expand internally. The company may grow externally by acquiring or merging with other companies in a particular industry. This option may be easier, faster, and cheaper than internal growth since it may be not involved installing or expanding production facilities, developing new products, etc in the short run.

e) Limit competition and increase market power.

Two or more firms in the same line of business may merge to eliminate or reduce competition among them. This may not be in the interest of the customers particularly if there are only few firms in that line of business. This may lead to the merged firm to have monopoly power.

f) Tax Shields

The company may have accumulated losses and/or unabsorbed capital allowances over the years and little prospects of making sufficient profits in the foreseeable future to absorb the losses and capital allowances.

Tax complications

- **Tax Implication of a New company Take Over**

  Where a new company takes over an existing company the trade or business of the existing company ceases, thus, cessation provisions will apply to that company that has taken over. The new company commences a new business. Commencement provisions will apply to new company.

- **Tax Implication of a Merger Resulting in the Continuation of the consolidated business**

  Where an existing company acquires or absorbs another company, the operation of the company acquired or absorbed ceases.

  Therefore, the cessation provisions of the Act will be applied to that company.

  In respect of the company taken over, consideration will be made as to the nature of the company’s trade or business both before and after takeover.

If a trade or business carried on by the company is the same before and after the takeover, the company cannot be said to commence a new trade or business. This will be the case if the trade or business of the company that is taken over is essentially the same as the trade or business of the company that requires it. In such circumstances, commencement provision will not be applied.

However, if the trade or business of the absorbed company is different from that of the company that acquires it, the company acquiring will be deemed to have commenced a new trade or business. In such situation, the commencement provision of the Act will apply to the new trade or business while the existing business of the company will be assessed on a continuing trade basis.

Illustration

King Limited and Queen Limited merged and a new company, King-Queen Limited was established which takeover all undertakings, assets and liabilities of King Limited and Queen Limited with effect from 1st October, 2012. King-Queen Limited adopted 30th September as its accounting year end.

The trading results of the two companies, as adjusted for income tax purposes, were as follows:

Kings Limited	₦
Year ended 30/06/2009	4,000,000
Year ended 30/06/2010	3,500,000
Year ended 30/06/2011	2,500,000
Year ended 30/06/2012	2,600,000
Period to 30/09/2012	(1,865,000)

Queen Limited

Year ended 30/09/2009	4,500,000
Year ended 30/09/2010	3,200,000
Year ended 30/09/2011	2,400,000
Year ended 30/09/2012	1,500,000

King-Queen Limited

Year ended 30/09/2013	7,000,000

Capital allowance were computed and agreed with the FIRS as shown below

Year of Assessment	Kings Ltd	Queen Ltd	King-Queen Ltd
	₦	₦	₦
2010	1,000,000	2,500,000	
2011	1,850,000	2,320,000	
2012	2,150,000	250,000	6,500,000
2013			3.855,000
2014			3,785,000

Required:

Determine the companies tax Liabilities for the relevant years of assessment.

Solution

a) **KING LIMITED**

Determination of Tax Liabilities

Year of Assessment	₦	₦
2010		
1/07/08- 30/06/09		
Assessable profit		4,000,000
Capital allowance		(1,000,000
Taxable profit		3,000,000
Tax liabilities at 30% of taxable profit		900,000
Education at 2% of assessable profit		80,000
2011		
Penultimate year		
Assessable profit: higher of		
PYB: 1/07/09 -30/06/10	3,500,000	3,500,000
AYB: 1/01/11- 31/12/11		
(6/12 x ₦2,500,000 + 6/12 x ₦2,600,000)	2,550,000	
Capital allowance		(1,850,000)
Taxable profit		1,650,000
Tax liability at 30% of taxable profit		495,000
Education tax at 2% of assessable profit		70,000

2012	
1/01/12 – 30/09/12	
Profit (1/01/12 – 30/06/12 = 6/12 x ₦2,600,000)	1,300,000
Loss (1/07/12 – 30/09/12)	(1,865,000)
Unrelieved loss at cessation	565,000
Unrelieved capital allowance at cessation	2,150,000

b)

QUEEN LIMITED

Determination of Tax Liability

Year of Assessment	₦	₦
2010		
1/10/08 – 30/09/09		
Assessable profit		4,500,000
Capital allowance	(2,500,000)	(2,500,000)
Restricted to 2/3 of Assessable profit	3,000,000	
Unrelieved capital allowance c/f	Nil	
Taxable profit		2,000,000
Tax liability at 30% of taxable profit		600,000
Education tax at 2% of assessable profit		90,000

2011

Penultimate year		
Assessable profit: Higher of:		
PYB: (1/10/09 – 30/09/10)	3,200,000	3,200,000
AYB: (1/01/11 – 31/12/11)		
(9/12 x ₦2,400,000 + 3/12 x ₦1,500,000)	2,175,000	
Capital allowance	2,320,000	
Restricted to 2/3 of Assessable profit	(2,133,333)	(2,133,333)
Unrelieved capital allowance c/f	186,667	
Taxable profit		1,066,667
Tax Liability at 30% of taxable profit		320,000
Education tax at 2% of assessable profit		64,000

2012

1/01/12 – 30/09/12		
Assessable profit (9/12 x ₦1,500,000)		1,125,000
Capital allowance:		
Unrelieved capital allowance b/f	186,667	
Capital allowance for the year	250,000	
Total capital allowance	436,667	(436,667)
Taxable profit		688,333
Tax liability at 30% of taxable profit		206,500
Education tax at 2% of assessable profit		22,500

c) **KINGS-QUEEN LIMITED**

Computation of Tax Liability

Year of Assessment		₦	₦
2012			
1/10/12 – 31/12/12			
Assessable profit (3/12 x ₦7,000,000)			1,750,000
Capital allowance		6,500,000	
Restricted to 2/3 of Assessable profit		(1,166,667)	(1,166,667)
Unrelieved capital allowance	c/f		5,333,333
Taxable profit			583,333
Tax liability at 30% of taxable profit			175,000
Education tax at 2% of assessable profit			35,000
2013			
1/10/12 – 30/09/13			
Assessable profit			7,000,000
Capital allowance			
Unrelieved capital allowance	b/f	5,333,333	
Capital allowance for the year		3.855,000	
Total capital allowance		9,188,333	
Restricted to 2/3 of Assessable profit		4,666,667)	(4,666,667)

Unrelieved capital allowance	c/f	4,521,666	
Taxable profit			2,333,333
Tax liability at 30% of taxable profit			700,000
Education tax at 2% of assessable profit			140,000
2014			
1/10/12 – 30/09/13			
Assessable profit			7,000,000
Capital allowance			
Unrelieved capital allowance	b/f	4,521,666	
Capital allowance for the year		3,785,000	
Total capital allowance		8,306,666	
Restricted to 2/3 of Assessable profit		(4,666,667)	(4,666,667
Unrelieved capital allowance	c/f	3,640,000	
Taxable profit			2,333,333
Tax liability at 30% of taxable profit			700,000
Education tax at 2% of assessable profit			140,000

Review Questions

- State and discuss five reasons for the merger and acquisition of companies.
- State the tax implications of amalgamation, absorption, and takeovers would depend on the type of particular arrangement.
- State the tax implications where a business carried on by a company is sold or transferred to a Nigerian company and both companies are members of a recognized group of companies.
-

References

- **Adejola, P. A** (2015): Revision Pack on Taxation for Professional, Conversion and Undergraduate Students, Arogbodo Press, Abuja.
- **Bassey U. O** (2013): **:** "Companies Taxation in Nigeria", the CIBN Press Ltd, Lagos.
- **Seyi Ojo** (2006): "Fundamental Principles of Nigerian Tax", Sagribra Tax Publications, Lagos 2003.