

DUE DILIGENCE IN MERGERS AND ACQUISITIONS

Mergers and acquisitions are a tool to grow business, to make more money and serve a larger customer base, at a rapid pace (in contrast with organic growth). This notwithstanding, pursuing mergers and acquisitions does not come without, among others, financial and legal challenges. The due diligence process, assessing the financial and legal status of merging companies or target, is arguably the most important part of a merger and acquisition, as it can prevent financial and legal problems in the future.

From the legal point of view, assessing the strengths and weaknesses of merging companies/target, successful tax planning and locating regulatory requirements are among key indicators for success in merging or taking over. For this, good correspondence (timely and detailed communication of relevant information and documents) is vital.

Non-Disclosure Agreements

Companies are, in general, cautious to share information, especially, financial information, important contracts, information on income (salaries, bonuses) and employees' personal data, and often seek reliable tools to protect the sensitive information. Confidentiality of information in Azerbaijan is regulated, among others, by Law No 224-IIQ of the Republic of Azerbaijan, *On Commercial Secrecy*, dated 4 December 2001, (the "**Commercial Secrecy Law**") and Law No 998-IIIQ, *On Personal Data*, dated 11 May 2010.

The Commercial Secrecy Law establishes the list of information, which is open. Information in constitutional documents (excluding a shareholder/participant's share/interest), information in licenses and permits, financial statements (including audit opinion), information on taxpayer (excluding tax secrets), information on salaries and social payments are, among others, open.

An owner of confidential information determines the regime of such information. Persons other than the owner of confidential information may determine the regime of such information based on a non-disclosure agreement entered with the owner. Such agreement embraces provisions, among others, on acquisition and disclosure of confidential information, ways of protection, methods and means of transmission of confidential information and terms of use of confidential information.

Law does not stipulate timeframes for protection of confidential information, nor does it set forth limits on remedies in case of a breach of confidentiality obligation. These are left to parties' sole discretion.

Some Issues to Review

Merger Control

Azerbaijan's merger control is governed by Law No 526, *On Antimonopoly Activity*, dated 4 March 1993.

Azerbaijani antimonopoly regulations apply to local-to-local transactions, as well as, local-to-foreign and foreign-to-local transactions provided that these transactions impair competition in the relevant Azerbaijani market. The State Service for Antimonopoly Policy and Protection of Consumer Rights under the Ministry of Economy of the Republic of Azerbaijan (to be reorganised into the State Antimonopoly and Control of Consumer Market Agency) extends its reach to also foreign-to-foreign transactions which lead to the restraint of competition in Azerbaijan.

If the restraint of competition is established, the transaction must meet the filing criteria applicable to mergers – acquisition of more than 35 per cent of the relevant market and acquisitions – acquisition of more than 20 per cent of the shares of a company in Azerbaijan or acquisition of assets in Azerbaijan constituting more than 10 per cent of the balance value of the seller. If this criterion is met, further thresholds will apply.

A failure to notify a qualifying transaction is punishable by a financial sanction of up to AZN5,500. The antimonopoly authority is allowed also to impose a sanction for a failure of business subjects to implement its (the Ministry of Economy's) instruction at AZN55 per each day of a failure not exceeding AZN22,000 in total. Upon a failure to pay these for more than 30 days, these are written off in an uncontested manner.

Employment

When a company is considering a merger or weighing the idea of an acquisition, it is critical to assess the impact on employment issues, such as transfer of employees to a new company, transfer of the liability of preceding employer to the succeeding employer.

Azerbaijani employment laws are considered generally employee-friendly. A change of ownership of an enterprise does not affect employment agreements of employees (except for the head of an enterprise, his/her deputies, chief accountant, and heads of departments) and they continue in effect. In connection with the change of ownership, employment agreements of the head of an enterprise, his/her deputies, chief accountant and heads of departments can be amended or terminated.

Mass termination of employment agreements within three months of the change of ownership is not allowed without a reasonable ground. Mass termination means termination of: (i) 50 percent of employees in enterprises with 100-500 employees; (ii) 40 percent of employees in enterprises with 500-1,000 employees; and (iii) 30 percent of employees in enterprises with over 1,000 employees.

Taxation

Uncareful consideration of tax issues in mergers and acquisitions may result in large taxation, thereby, potentially affecting the overall price, at which the transaction was undertaken. Taxwise, an acquisition can take place in various forms, namely, share purchase, enterprise sale, and asset sale.

Share Deal

The major tax implication of share acquisition is liability to a tax on the capital gains. The Azerbaijani Tax Code does not define a capital gain or provide for a capital gains tax. Nevertheless, there is a concept of "out-of-sale" proceeds defined generally as proceeds from transactions not directly related to the production or sale of goods, performance of works, and provision of services; such proceeds include "income from participation in operations of other enterprises, income from taxpayer's shares, bonds, and other securities". There are no rules in the Tax Code in relation to taxation of "out-of-sale" proceeds in the context of the personal income tax.

One issue with the taxation of share sale is valuation of shares when they are sold at a nominal value. When shares are sold at a price higher than the company's net asset value per share, the difference between the intrinsic sale price and the nominal value of the sold shares is taxable. When shares are sold at a price lower than the company's net asset value per share, income received from the difference between the value of respective net assets at a date of contract conclusion and the nominal value of interest/share in the charter capital is taxable.

Enterprise

A transfer of business can be exempt from the value added tax (VAT) if (i) what is acquired is enterprise (a going concern), (ii) the acquisition is a single transaction between two taxpayers, and (iii) the parties notify a tax authority of applicability of Section 160 of the Tax Code to the acquisition within ten days of the transfer of enterprise. As a result of applicability of this VAT exemption, all current liabilities (not limited to tax) of the enterprise being acquired pass to a purchaser.

Asset Deal

Under Sub-Section 142.1 of the Tax Code, a person's income from disposition of an asset is determined by reference to the positive difference between the proceeds from the sale and cost of the sold asset determined pursuant to Section 143 of the Code. Section 143 stipulates that the cost of an asset includes expenses incurred in its acquisition, delivery, manufacture and assembly, and other expenses (except for non-deductible expenses) increasing the asset's value.

Should shares in the LLC be regarded a capital asset, no (ordinary business) deductions can be taken from the income from disposition of them as determined pursuant to Sub Section 142.1 of the Tax Code. In practice, however, the Azerbaijani tax authorities regard "out-of-sale" proceeds, including from the disposition of shares, as a taxpayer's ordinary income, from which tax deductions can be taken.

COURT REFORM

Decree of 3 April 2019 of the President of Azerbaijan concerns reforming the system of courts of law.

The Decree proposes adoption of legal acts: (i) humanising punishment policy and promoting decriminalisation, (ii) improving access to and quality of business courts by establishing a specialised court, (iii) establishing a task for the Supreme Court's forming a single court practice and a mechanism to implement such, and (iv) requiring audio-recording of hearings and preparing minutes of the hearings according to such recordings, among certain others.

The Judicial Legal Council is advised, among others, to: (i) establish a hotline and (ii) monitor publishing electronically of court decisions and random distribution of cases among judges.

The Ministry of Justice is required to: (i) ensure wider implementation of the "e-execution" information system and (ii) report to the President on alternate mechanisms of execution of decisions of courts and other bodies and of expert testimonies in courts.

The Cabinet of Ministers is required to draft regulations providing for payment of fees for legal aid undertaken by the State to the Collegium of Advocates (Bar).

INTELLECTUAL PROPERTY

By Law of 19 February 2019, the state duty amounts for the following were approved:

- registration, issuing patent and publication of an invention, utility model, industrial (registered) design;
- issuing sub-patent;
- revising a patent;
- registering agreements for transferring rights of invention, utility model, and industrial (registered) design;

- registering, publication of information, and issuing a certificate (for a trademark, geographical index, and collective trademark);
- updating register and certificate;
- issuing certificate for licensing a trademark and geographical index;
- registering agreements for transferring rights in a trademark;
- issuing certificate to a patent attorney; and
- applying with an objection to an appellate council.

PLEASE CONTACT US FOR ANY QUESTIONS AND FURTHER INFORMATION AT:

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