United Kingdom

United Kingdom

General

1. What are recent tax developments in your country which are relevant for M&A deals?

The main developments in the UK relevant to M&A transactions are the implications of the BEPS actions. The UK is generally supportive of the BEPS actions and has already issued various statements and draft legislation.

- Action 2: draft hybrid mismatch legislation has been published to take effect from 1 January 2017
- Action 4: a consultation has been issued on interest deductibility although rules are not likely to be in place before April 2017
- Action 5: HMRC is amending the UK patent box regime to incorporate the nexus principle
- Action 6: It expected that the UK will prefer the principal purpose test and to implement this via the multilateral instrument being developed under Action 15
- Action 13: The UK has already implemented country-by-country reporting, effective from 1 January 2016

No amendments were required to UK legislation in respect of the EU GAAR being incorporated into the PSD as the PSD is not used for dividends paid from the UK and there are already anti-avoidance rules to counter tax avoidance motives for dividends paid into the UK.

The UK's current corporation tax rate is 20% and it has been announced that this will decrease to 19% from April 2017 and to 17% from April 2020. The decrease in the tax rate is expected to be offset with an increase in the tax base by increasing anti-avoidance provision. Therefore tax-payers should take care when undertaking tax planning.

2. What is the general approach of your jurisdiction regarding the implementation of OECD BEPS actions (action Plan 6 specifically) and, if applicable, the amendments to the EU Parent-Subsidiary Directive.

Please see question 1.

3. What are the main differences among acquisitions made through a share deal versus an asset deal in your country?

Share deals

The purchase of shares means that the purchaser acquires the entire company. This includes all assets and all liabilities including any historical liabilities.

The purchase of shares in the UK results in few immediate tax deductions – there is no form of deductible amortisation on the purchase price of shares and no ability to rollover qualifying gains from the sale of other assets into the shares purchase price.

One advantage of purchasing the shares in a target company is the possible use of losses in the target company against its future profits, subject to anti-avoidance provision mainly aimed at ensuring that the profits are generated from the same activity. Losses from pre-acquisition periods in the target company cannot be offset against profits arising from the corresponding period in the acquiring company. But post-acquisition, it should be possible to group relieve profits and losses between the target company and the acquiring company, provided the ownership conditions are met (broadly, being 75% ownership of the ordinary shares).

Stamp duty at 0.5% of the consideration is payable on the acquisition of shares.

The sale of the shares in the target company may qualify as a tax-free disposal – there is an exemption whereby gains (and losses) on the disposal of shareholdings of 10% or more in trading companies or trading groups are exempt from tax, under the "substantial shareholding exemption".

The sale of shares is often more attractive to vendors because there are more reliefs available and lower rates of tax on gains.

UK-resident individual sellers of shares are typically taxed at 28%. This compares favourably with the highest rate of income tax in the UK, which is currently 45%.

Asset deals

In asset deals, purchasers can choose the assets they want and leave any unknown liabilities behind.

There is also greater scope for immediate and future tax deductions. For example on stock, assets that qualify for capital allowances and certain intangible assets, would typically qualify for tax deductions. Furthermore, certain assets purchased may qualify for rollover relief so a purchaser can defer other gains into these acquisitions.

There are potentially higher base costs in assets acquired for capital gains tax purposes. Broadly the tax basis of each relevant asset will be the amount paid for it.

However, any accumulated losses would remain with the vendor entity.

The purchase of assets may qualify as a transfer of a going concern and, as such, VAT need not be accounted for on the sale.

However there are potentially higher stamp duty costs, as stamp duty land tax of up to 4% of the consideration is payable for transactions relating to UK non-residential land or real estate.

An asset deal is often less attractive for vendors than a share deal because of the potential double tax charge for shareholders, as balancing charges and capital gains arising will fall on the disposing company.

Pre-sale hive down of trade and assets

Prior to April 2011, where a company left a group holding assets that have been transferred to it from other group companies, these assets were deemed to have been disposed of at market value and then re-acquired. This crystallised a capital gain 'de-grouping' charge in the transferee company. This generally made a pre-sale hive down unattractive.

However, since 1 April 2011, these rules have been relaxed. The de-grouping charge is calculated in the same way but now the gain is not crystallised in the transferee company, instead it is added to proceeds for the sale of shares. Where the trade and assets transferred were used for the purposes of the transferor group's trade, the gain on shares disposal may be exempted under the substantial shareholdings exemption. The combined result of this is that the purchaser gets a clean company holding assets which have been re-based to market value and the vendor is exempted from tax on the disposal. Any accumulated trade losses would also transfer to the new company.

4. What strategies are in place, if any, to step up the value of the tangible and intangible assets in case of share deals?

There is generally no ability to step up the value of assets in a share deal. However, this can effectively be achieved by a pre-sale hive down, as described in the previous section.

5. What are the particular rules of depreciation of goodwill in your country?

UK tax legislation enables a company that has purchased "intangible fixed assets", to claim tax relief broadly to the extent that the acquisition cost is amortised in the company's accounts. A buyer can elect to have intangible fixed assets depreciated at a fixed rate of 4% per year regardless of the amount of depreciation taken through to the profit and loss account. This is particularly relevant for companies that account under International Accounting Standards (IAS). This tax-deductible goodwill arises on asset acquisitions.

Tax-deductible goodwill depreciation is not available on share deals.

6. Are there any limitations to the deductibility on interest of borrowings?

UK Revenue authorities may restrict interest deductions on intra-group debt (e.g. a push-down of acquisition debt) in the UK unless it can be demonstrated that an independent third party lender would enter into the transaction. To the extent that interest charged on connected party lending is deemed to be excessive it will be disallowed for tax purposes.

For justification that the lending is at arm's length rates typically UK Revenue would want to see forecasts [from whom] and would consider the level of interest cover and gearing ratios, comparing these to what would

be required by a third party lender. It is possible to obtain an Advance Thin Capitalisation Agreement (ATCA) with the UK Revenue, which would give certainty on the amount of interest that will be deductible. However, this will often include gearing covenants.

Worldwide debt cap legislation also applies to interest deductions available to UK companies. Under these rules, the interest deduction is capped by reference to the net external finance costs of the worldwide group.

UK tax legislation also contains anti-avoidance provisions that can deny interest deductions where the loan is deemed to have been borrowed for unallowable purposes (which broadly means that the loan was obtained to secure a tax advantage).

From 1 April 2017, the UK will implement a fixed ratio rule limiting UK corporation tax deductions for net interest expense to 30% of a group's UKEBITDA (earnings before interest, tax, depreciation and amortisation). If it gives a more favourable answer, groups will be able to use a group ratio rule to determine whether additional interest amounts are deductible in the UK. This will be based on the net interest to EBITDA ratio of the worldwide group. The rules will not apply to groups with net UK interest expense under £2m.

7. What are usual strategies to push-down the debt on acquisitions?

Typically, from a UK standpoint, in order to push down debt on an acquisition, a new local holding company is established to carry out the acquisition so interest on the debt can be relieved against the target company's profits under the UK's group relief provisions. Broadly, UK companies can surrender profits and losses within a group providing that a common parent holds at least 75% of the ordinary share capital.

It may also be possible to borrow to finance distributions from the target company although this would need more careful consideration in respect of anti-avoidance provisions.

8. Are losses of the target company/ies available after an acquisition is made?

There are 4 main categories of tax losses in the UK:

- Trading losses
- Management expenses
- Losses arising from interest deductions
- Capital losses

These losses remain with the corporate entity and do not transfer on a sale of assets. A comprehensive set of anti-avoidance rules have been introduced to block transactions where the primary benefit to the buyer or to the seller was the existence of tax losses within the target company.

Trading losses

If a target company has incurred trading losses in its current or earlier accounting periods, a buyer will need to know whether the losses will be available to the target company in future accounting periods. The UK anti-avoidance rules on trading losses apply where there is a change in ownership and either:

- There is a major change in the nature or conduct of the company's trade within 3 years on either side of the change in ownership change

- The change of ownership occurs between the sale of the company's activities becoming small or negligible and a considerable revival of its trade

Where the above applies, losses arising before the change in ownership will not be allowed to be offset against profits after the change of ownership

Similar anti-avoidance rules also apply to surplus management expenses and interest losses.

Capital losses

UK tax legislation contains anti-avoidance rules designed to restrict the offset of losses against gains when a company becomes a member of a group. Such losses can only be set against gains on assets that are used for the continuing business of the company joining the group.

Currently losses carried forward can only be used by the company that incurred the loss, and not used in other companies

in a group. In addition, some losses carried forward can only be set against profits from certain types of income, for example trading losses can only be set against future profits of the same trade. For corporation tax losses incurred on or after 1 April 2017, companies will be able to use carried forward losses against profits from other income streams or from other companies within a group.

From 1 April 2017 only 50% of taxable profits can be offset by carried-forward losses. The restriction is intended to apply to profits in excess of £5m.

9. Is there any indirect tax on transfer of shares (stamp duty, transfer tax etc)?

Stamp duty is generally charged at 0.5% of the consideration paid to acquire shares. Where shares are transferred within a group of companies, relief may be available depending upon specific ownership requirements. Typically these requirements hold that the companies must form part of a group in which (i) are 75% subsidiaries of a common parent or (ii) have at least a 75% parent- subsidiary relationship.

There should be no significant VAT issues. VAT is not charged on the disposal of shares, although there may be restrictions on the recoverability of VAT on legal and professional costs associated with the share disposal.

10. Are there any restrictions on the deductibility of acquisition costs?

Costs relating to obtaining loan finance are tax deductible. Relief will generally be available following in accordance with the accounting treatment. These costs would include bank arrangement fees, loan arrangement fees and professional fees incurred to secure the finance.

Expenses relating to the acquisition of an investment which are capital in nature are not tax deductible. Generally expenditure on appraising and investigating investments will be revenue in nature (and deductible) until the time when the 'acquisition process' commences. Expenditure incurred from that point will be capital in nature.

11. Can VAT be recovered on acquisition costs?

In the past, the UK tax authorities took a tough stance on VAT recovery in relation to corporate acquisitions and challenged many taxpayers claiming recovery of VAT on these costs. However, since the CJEU released its judgment in Larentia+Minerva in July 2015, they appear to generally accept that an active holding company should be entitled to recover VAT incurred when acquiring a new subsidiary, provided the holding company will actively manage the new subsidiary and charges fees for doing so.

12. Are there any particular issues to consider in the acquisition by foreign companies?

There are few particular issues to consider when a UK company is acquired by a foreign company. This is largely due to:

- The UK not imposing withholding tax on dividend payments
- The absence of non-resident capital gains tax

However, the UK does impose withholding tax on interest payments and for a foreign company to benefit from reduced rates under tax treaties, the lender would need to have beneficial ownership of the interest income. There is a statutory exemption from withholding tax if the debt is listed on a recognised stock exchange.

13. Can the group reorganise after the acquisition in a tax neutral environment? What are the main caveats to consider?

UK tax legislation contains provisions that enable a tax-neutral reorganisation, such as divisionalisation. These include:

- The ability to transfer assets of a trade, together with accumulated losses, within a group without a charge to tax
- The tax neutral transfer of assets within a group under the chargeable gains regime
- The ability to surrender tax losses within a group (but see above regarding restrictions
- Tax free share-for-share exchanges, provided certain conditions are met
- Group relief provisions for stamp duty and stamp duty land tax
- Group provisions for reorganisations that take place within a VAT group

When considering a group reorganisation post-acquisition, care needs to be taken with regard to future de-grouping charges that may apply for 6 years if the company is sold outside the group. There are also stamp duty and stamp duty land tax relief clawback provisions that apply for 3 years.

14. Is there any particular issue to consider in the case of companies whose main assets are real estate?

There are no particular issues to consider in the case of companies whose main assets are real estate. However, anti-avoidance provision may apply where a property trading, rather than investment, activity is undertaken in a corporate wrapper in order to achieve capital gains treatment on sale of the shares.

From a Seller's Perspective

15. How are capital gains taxed in your country? Is there any participation exemption regime available?

Capital gains realised by companies is subject to tax at the standard corporation tax rate.

Capital gains tax realised by individuals is generally taxed at 28%. Reduced rates may be available if the shares disposed of were structured as an employee incentive scheme.

The only participation exemption for capital gains tax is in the substantial shareholding exemption. This exemption applies to the disposal of shareholding greater than 10% held for a continuous period of more than 12 months. The seller must be a trading company or a member of a trading group and the company sold must also be a trading company or the holding company of a trading group.

16. Is there any fiscal advantage if the proceeds from the sale are reinvested?

There is a fiscal advantage to reinvesting proceeds from an asset sale. Rollover relief may be claimed if an amount equal to the proceeds from the sale of qualifying assets is reinvested into other qualifying assets within either (i)12 months prior to the sale or (ii) 3 years following the sale. For this purpose, qualifying assets include freehold land and buildings, as well as plant and machinery. Alternatively, a separate form of relief is available on the acquisition of depreciating assets (e.g. leasehold property), so that the gain can be held over for a maximum of 10 years with potential for further rollover.

Shares are not qualifying business assets for the purposes of rollover relief, so the vendor is not able to match the gain on any sale of shares with the purchase of another asset even if that asset does qualify for rollover relief.

17. Are there any local substance requirements for holding/finance companies?

The main UK requirement arises where a UK company is paying interest and is claiming a reduced rate under a double tax treaty. Here, to benefit from the treaty, the recipient would need to have beneficial ownership of the interest receipt. Following the famous Indofoods, HMRC take the view that beneficial ownership should be determined using the "international fiscal meaning", whereby the recipient should 'enjoy the full privilege to directly benefit from the income'. Where the recipient is bound in legal, commercial or practical terms to pass on the income, they will not be the beneficial owner of the income. Although, following implementation of BEPS Action 6, the position is likely to become more onerous.

As the UK does not impose withholding tax on distributions or on a non-resident's capital gain, substance considerations are not usually an issue here.

In 2015 the UK introduced the 'diverted profits tax' which in summary charges tax (at a higher 25% rate) where a company, which is taxable in the UK, creates a tax advantage by involving entities or transactions which lack "economic substance". For example, a UK company transfers IP to a related entity and then pays a UK tax deductible royalty to such related entity and the related entity does not have the technical and management capacity to develop, maintain and exploit such IP or, a foreign company structures its affairs so as to avoid a UK taxable presence where there is UK based activity.

Your Taxand contact for further queries is:

United Kingdom

Dafydd Williams
T. +44 207 072 3215
E. dwilliams@alvarezandmarsal.com

Ian Fleming
T. +44 207 663 0425
E. ifleming@alvarezandmarsal.com