UNITED KINGDOM

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INTERNATIONAL DEVELOPMENTS

1. WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

The main developments in the UK relevant to M&A transactions are the continued implementation of the BEPS actions into domestic legislation. The UK is generally supportive of the BEPS actions and has already issued legislation. In particular, the UK tax authority has introduced new legislation in the following areas:

- Action 2: Hybrid mismatch legislation took effect from 1 January 2017
- Action 4: Corporate interest deduction - restricting tax deductions available for interest expense based on 30% of the UK group's EBITDA or a group ratio based on actual net third party interest to EBITDA for the worldwide group, which took effect from 1 April 2017
- Action 6 / 15: The UK signed the MLI in June 2017 and introduced draft legislation to implement the modification of bilateral tax treaties to implement tax treaty measures developed as part of the BEPS project
- Corporation tax loss carried forward rules – restricting the amount of carried forward losses which can be offset in the future but providing more flexibility in how losses can be relieved, took effect from 1 April 2017
- Substantial Shareholding Exemption changes – which simplifies the UK capital gains participation exemption requirements and should make it available more widely.

Since 1 April 2017, the UK's corporation tax rate has been 19% and it has been announced that this will decrease 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 provisions.

2. WHAT IS THE GENERAL APPROACH OF YOUR JURISDICTION REGARDING THE IMPLEMENTATION OF OECD BEPS ACTIONS (ACTION PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVES?

The UK government successfully helped initiate the G20-OECD BEPS project, and worked with G20 and OECD partners to bring this to a successful conclusion in October 2015 and deliver the 2015 Final Reports. The UK's objective has been to ensure that profits are taxed where the economic activity generating them takes place.

In 2014, the UK was one of the first countries to implement the OECD country-by-country reporting template, which will improve transparency of business to tax authorities. The UK continues to be one of the leading countries pushing the BEPS agenda and in some cases, has adopted stricter measures than anticipated.

Action 6 lays down requirements for the availability of treaties to be limited to situations where a 'principle purpose test' (PPT), based on the transactions or arrangements, is met. The PPT can be separately supplemented by a 'limitation on benefit's' (LOB) rule which limits treaty benefits to persons who meet certain conditions. The UK will adopt the PPT through the multilateral instrument (MLI) but will not seek to include the supplementary LOB provisions.

Action 15 of the OECD's Base Erosion and Profits Shifting (BEPS) project recommended the development of a multilateral instrument (MLI) to allow countries to swiftly modify their bilateral treaties to implement tax treaty related measures developed as part of the BEPS work. The UK signed the MLI in June 2017 and introduced draft legislation to implement the MLI into UK law.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES BETWEEN AN ACQUISITION OF SHARES AND AN ASSET DEAL IN YOUR COUNTRY?

A) Share deal

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 provisions which may arise following a change of ownership.

Stamp duty at a rate of 0.5% of the consideration paid 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 a rate of 20%. This compares favourably with the highest rate of income tax in the UK, which is currently 45%.

B) Asset deal

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

There is also greater scope for immediate and future tax deductions. For example, the acquisition of stock and assets that qualify for capital allowances and certain IP would typically qualify for tax deductions. Further, 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 and further tax charges are likely to arise when proceeds are distributed to shareholders.

C) Pre-sale hive down of trade and assets

Where a company leaves a group holding assets that have been transferred to it from other group companies on a tax-neutral basis, these assets are deemed to have been disposed of at market value and then re-acquired. This crystallised a capital gain 'de-grouping' charge which in most cases is added to the 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 the disposal of shares 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. It should be noted that this treatment does not apply to certain intangible assets. Any accumulated trade losses would also transfer to the new company.

BUY-SIDE

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 AMORTISATION OF GOODWILL AND SIMILAR INTANGIBLE ASSETS IN YOUR COUNTRY?

Amortisation arising on the acquisition of all goodwill or customer related intangibles (including those arising from an asset acquisition) is no longer deductible for corporation tax purposes.

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

6. WHAT ARE THE LIMITATIONS ON THE DEDUCTIBILITY OF INTEREST EXPENSE? ARE THERE SPECIAL INTEREST LIMITATIONS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

The UK tax authority may restrict interest deductions on related party 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 related party lending is deemed to be excessive it will be disallowed for tax purposes. It is possible to obtain an Advance Thin Capitalisation Agreement (ATCA) with the UK tax authority, which would give certainty on the amount of interest that will be deductible. However, this will often include gearing covenants.

In addition, the UK introduced a new regime with effect from 1 April 2017 that restricts the tax deductions that are available for interest expense based on the higher of: (i) 30% of the UK group's tax-EBITDA, or (ii) group ratio based on the actual net third party interest to EBITDA ratio for the worldwide group. This new rule implements BEPS Action 4 recommendations.

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 mean that the loan was obtained to secure a tax advantage).

7. WHAT ARE COMMON STRATEGIES TO PUSH-DOWN DEBT ON ACQUISITIONS?

Typically, from a UK standpoint in order to push down debt on an acquisition, a new UK holding company is established and leveraged 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 THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

In the UK there are no tax incentives for equity financing an acquisition of a target company.

9. ARE LOSSES OF A TARGET COMPANY AVAILABLE AFTER AN ACQUISITION IS MADE? ARE THERE ANY RESTRICTIONS ON THE USE OF SUCH LOSSES?

Trade tax losses incurred prior to 1 April 2017 and carried forward should generally be available to be used against future taxable profits of the same trade in the entity which incurred the tax losses.

Trade tax losses incurred after 1 April 2017 may be carried forward and set-off against future taxable profits of different activities within a company and its UK group companies. Following a change in ownership any pre-acquisition carried forward losses (incurred after 1 April 2017) in the acquired company cannot be group relieved against the profits of companies in the acquiring group (i.e. entities which were not part of its pre-acquisition group) for a period of five years.

Where the group's taxable profits exceed £5m, the amount of annual profit that can be relieved by carried forward trade losses will be limited to 50% of the group's profits.

Carried forward trade losses may be forfeited following a change of ownership under UK anti-avoidance rules 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 a period of 5 years, beginning no later than the change in ownership and no earlier than 3 years before change in ownership; or
- The change of ownership occurs at any time after the scale of the company's activities has become small or negligible and before any significant 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.

Change of ownership restrictions also apply to non-trade tax losses.

Targeted anti-avoidance rules also apply to carried forward tax losses.

In the UK losses remain with the corporate entity and do not transfer on a sale of assets.

10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?

The UK tax legislation is amongst the most complicated in the world and has over the last couple of years undergone significant changes including the adoption of many of the BEPS action points. Therefore, it is advisable to use UK tax specialists when dealing with the acquisition or disposal of a UK tax resident entity. Particular areas that should be considered within the scope of a tax due diligence are the recent corporation tax changes in the UK tax legislation around hybrids and anti-avoidance and the R&D tax relief scheme which is fairly widely available but complex.

11. IS THERE ANY INDIRECT TAX ON TRANSFER OF SHARES (STAMP DUTY, TRANSFER TAX, ETC.)?

Stamp duty is generally charged at a rate of 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. The VAT registration of the target company may be disrupted by a sale of shares if they are in a VAT group.

12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX DEDUCTIBILITY OF ACQUISITION COSTS?

Costs relating to obtaining loan finance are tax deductible. Relief will generally be available 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.

13. CAN VAT (IF APPLICABLE) 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. HMRC published revised guidance (in April 2017) to confirm the position on the recoverability of VAT in light of the CJEU judgment in Larentia+Minerva in July 2015. HMRC appears to generally accept that an active holding company should be entitled to recover VAT incurred when acquiring a new subsidiary, provided that the holding company which receives advisors' services undertakes economic activity that supports the taxable trading services of the business and makes onward supplies (directly or indirectly) of management or similar services to all subsidiaries it acquires.

14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION OF A DOMESTIC COMPANY BY A FOREIGN COMPANY?

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.

15. CAN THE GROUP REORGANISE AFTER THE ACQUISITION IN A TAX NEUTRAL MANNER THROUGH MERGERS OR A TAX GROUPING?

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 if the company is sold outside the group within a period of 6 years. There are also stamp duty and stamp duty land tax relief claw back provisions that apply for a period of 3 years.

16. ARE THERE ANY PARTICULAR ISSUES TO CONSIDER IN THE CASE OF A TARGET COMPANY THAT HAS SIGNIFICANT REAL ESTATE ASSETS?

There have been significant recent changes for real estate investors and developers. Enacted and proposed legislation (subject to further consultation) include:

- Non-resident property developers are taxable on all UK development trading profits
- Anti-avoidance provisions for disguised property trading reinforced
- Non-resident property investors will be brought into the charge to UK corporation tax and capital gains tax
- Proposed new rules will apply to indirect disposals of property-rich companies.

17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?

The UK does not have a fiscal unity or consolidated group tax regime.

The basic UK corporation tax rules operate on a company by company basis and could in some circumstances result in unfair tax consequences for companies within a group. As a result, there are a number of UK tax rules which aim to eliminate or minimise such unfair tax treatments by recognising the existence of groups of companies. For instance, one advantage a group has is group relief which is a mechanism that allows members of a group to share the benefit of certain corporation tax losses. One member of the group can surrender these losses to another member of the group, which can deduct the loss from its total profits, thus reducing the amount of corporation tax payable.

18. DOES YOUR COUNTRY HAVE ANY SPECIAL TAX STATUS SUCH AS A PATENT BOX FOR COMPANIES THAT HOLD INTANGIBLE ASSETS?

The UK Patent Box regime enables companies to apply a lower rate of corporation tax of 10% to relevant profits earned from its patented inventions. To qualify for the Patent Box regime the company must own or exclusively licence-in patents and must have undertaken qualifying development on the patents. A company may also benefit from the Patent Box regime if it uses a manufacturing process that is patented or provides a service using a patented tool.

19. DOES YOUR COUNTRY IMPOSE ADVERSE TAX CONSEQUENCES IF OWNERSHIP OF INTANGIBLES IS TRANSFERRED OUT OF THE COUNTRY?

Capital gains realised by companies on the sale of intangible assets is subject to the standard corporation tax rate.

The Diverted Profits Tax aims to ensure that the profits taxed in the UK fully reflect the economic activity in the UK and is consistent with the aims of the OECD's BEPS project. The Diverted Profits Tax is applicable to businesses that enter into arrangements to divert profits that reduce the UK tax base by either designing their activities to avoid creating a permanent establishment in the UK or creating a tax advantage by using transactions or entities that lack economic substance. The Divert Profits Tax imposes a 25% tax plus interest on any diverted profits (compared with the UK's lower corporation tax rate, 19% from April 2017).

SELL-SIDE

20. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY? WHAT, IF ANY, GAINS ARISING IN AN M&A CONTEXT ARE ELIGIBLE FOR SPECIAL TREATMENT?

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

The only participation exemption for capital gains tax for a corporate seller is the substantial shareholding exemption. This exemption applies to the disposal of a shareholding greater than 10%, held for a continuous period of more than 12 months within a period of 6 years prior to disposal. The company being sold must be a trading company or the holding company of a trading group.

Capital gains tax realised by individuals is generally taxed at a rate of 20% unless related to residential property which is at a rate of 28%. Reduced rates may be available if the shares disposed of were structured as an employee incentive scheme.

21. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES OR ASSETS 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.

22. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING COMPANIES?

Ihe 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. The UK tax authority takes 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", or, a foreign company structures its affairs so as to avoid a UK taxable presence where there is UK based activity.

23. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

Corporate reconstructions, mergers or de-mergers can often be carried out in a tax efficient manner but the rules are complex and anti-avoidance legislation may apply, particularly where there is an anticipated disposal.

MANAGEMENT INCENTIVES

24. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES IN CONNECTION WITH SELLING OR BUYING A COMPANY?

Generally, amounts received under management incentives schemes are subject to income tax plus national insurance contributions, with the employing company required to withhold the tax. Corporation tax deductions for these amounts are also generally available.

The granting of share options is not usually a taxable event. The income tax charge arises on the exercise of the option, when the individual receives the shares, and is based upon the difference between the market value of the shares and the price paid for the shares. Corporation tax relief may also be available on this gain provided various conditions are met in respect of the shares, mainly:

- They are a class listed on a recognised stock exchange
- They are shares in a company that is not under the control of another company
- They are shares in a company that is under the control of another company but the other company's shares are listed on a recognised stock exchange.

There is a tax advantaged share option scheme for smaller companies, known as the Enterprise Management Incentive (EMI). Under the EMI there is no income tax charge on exercise of the options. Instead there is a capital gains tax charge, at a lower rate than income tax, on the final disposal of the shares.

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