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cutting through complexity

M&A Tax Matters

Summer 2014

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Introduction

Welcome to the Summer edition of M&A Tax Matters

Starting things off in this edition are Mike Bacon and Laura Conroy who discuss the tricky situation of secondary liabilities in the context of restructuring transactions. Next, Emma-Lucia Durrant and Robert Venn consider the implications of the recent First-Tier Tribunal decision in *Intelligent Managed Services Limited v HMRC [2013] UKFTT741*. The case ruled that the transfer of business assets to an entity who is a member of a VAT group and who will only make supplies to other members of the VAT group, cannot be considered to be a transfer of a going concern for VAT purposes.

Moving on to the first in a two part series on IPOs from David Mortimore and Steven Heath; the first article looks at the process of preparing for an IPO and the potentially high volume of tax issues that a company will need to consider.

Punit Nathwani and Nicola Westbrooke then provide a brief introduction to the myriad of areas affected by the BEPS Action Plan with Richard Watson and David Gordon scratching beneath the surface of BEPS Action 6 in the following article.

Staying with the OECD, Jennifer Sponzilli walks us through the latest on global Automatic Exchange of Information; potentially further complicating due diligence procedures for multinational groups and following hot on the heels of the US FATCA regime.

Returning back across the pond, Iain Kerr considers US reverse triangular mergers: common means by which a UK Parent may acquire a US Target (and, more recently, may form one of the steps required to achieve a US inversion via a European merger).

In Europe, Wooi Hong Kuan and Mikko Saressalo discuss the ramifications of the CJEU judgement on *Felixstowe Dock and Railway Company v HMRC*. Consortium relief should be available pre-July 2010, notwithstanding that the 'link company' is not a UK resident. Finally, Matt Evans, Andrew Taylor and Harinder Soor look at the implications for transactions arising from the transitional provisions concerning Fixtures coming to an end.

We hope you'll enjoy this Summer edition of our publication. If you would like further detail on the articles in this issue, please call us, the authors, or your usual KPMG contact.

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Secondary liabilities and restructuring transactions

As the economy moves slowly forward on its road to recovery we are continuing to see a large number of, both lender and borrower led, company restructurings where the lenders take equity-like investments in return for their debt. Lenders contemplating such financial restructuring should reacquaint themselves with the "secondary liability rules" to ensure that they do not inadvertently fall within those rules as a result of being classified as a 'linked' person. We have recently seen several instances of HMRC pursuing shareholders for liabilities in connection with restructuring transactions in circumstances where it is not immediately apparent that the shareholder in question is 'linked' with the taxpayer. This article is intended to highlight some risk areas to be aware of when carrying out restructuring transactions.

The secondary liability rules

There are three types of secondary liability rules; those that deal with the withdrawal of group relief, those that deal with unpaid tax on chargeable gains and those that deal with unpaid tax in connection with a change in ownership. This article focuses on the change in ownership ("CIO") rules which are found in Part 14, Chapter 6 of CTA 2010.

The CIO rules have two key tests. One looks at unpaid tax in accounting periods beginning before the change in ownership (s710 CTA 2010 – the "backward-looking rule"). The other looks at unpaid tax in accounting periods ending on or after the change in ownership (s713 CTA 2010 – the "forward-looking rule").

The legislation is complex in this area, but broadly the backward-looking rule seeks to recover unpaid tax from 'linked persons' where there has been a CIO and a tax liability relating to periods beginning before that change remains unpaid six months after it is assessed. Conditions relating to a major change in the company's trade in the three years before and after the CIO also need to apply.

The forward-looking rule seeks to recover unpaid tax from linked persons in respect of periods beginning on or after a CIO, where the liability arose in connection with the CIO, was foreseeable, and (at the time of the CIO) it was expected that the liability would not be paid in full.

'Linked' persons

Where there is a CIO of a company, a person is linked to that company if:

1. that person had control of the company broadly any time in the three year period before the change; or
2. the person is a company over which the person mentioned in one above had control in the three year period before the change (s706 CTA 2010).

A person ("P") has control over a company ("C") if P exercises, is able to exercise, or is entitled to acquire the direct or indirect control over C's affairs. In particular P has control of C if P possesses or is entitled to acquire 50% of any of share capital, voting power, income available for distribution or the entitlement to assets on a winding up of C (s707 CTA 2010). A person can also be linked where two or more persons acting together could be said to satisfy the conditions (e.g. a lending syndicate).

Unexpected results?

The definition of control is complex and all of the s707 control tests need to be carefully considered. For instance, where the rights attached to the shares are non-standard, there are circumstances where the legislation could result in uncertainty as to whether a minority shareholder is a linked person. These implications can be particularly unexpected in more complex debt restructuring transactions where a lender may consider their investment to be primarily a debt investment, but a minority equity holding brings the lender within the definition of 'linked'.

For example, assume Company A is in financial distress. Company B, as part of a rescue restructuring, agrees to release Company A from its loan relationship debt in exchange for ordinary shares. As a result of the restructuring, Company B holds 5% of the share capital and voting rights in Company A. The shares rank *pari passu* with the other share capital in respect of the payment of dividends, but give Company B the right to the first £20m of cash on an exit or winding up. Immediately post restructuring Company A has a solvent balance sheet with net assets of £2 million. In these circumstances Company B would be entitled to all of the assets available to participators (as defined by s454 CTA 2010) on the winding up of Company A and would therefore be 'linked' to Company A.

Paradoxically, if the rescue restructuring left Company A with negative reserves and a negative net assets position, there would be no assets or income available for distribution and s707(3) (c) and (d) would arguably not be in point. In these circumstances, however, it would be necessary to monitor the position going forward, as Company B could become linked to Company A at some time in the future if Company A moved into a positive retained earnings or net asset position.

Whilst there are rules in other parts of the tax legislation (e.g. the group relief rules at s165(2) and s166(2) CTA 2010) where a notional £100 is substituted where the income available for distribution or assets on a winding up equals nil, it is thought that these could not be inferred to apply when considering s707.

Against this, it is clear that there is a need to carefully consider the secondary liability rules, in particular in the context of restructuring transactions where lenders may be contemplating an equity investment.

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Business asset purchases – beware a potential VAT pitfall

In the recent case of *Intelligent Managed Services Limited v HMRC [2013] UKFTT741* the First-Tier Tribunal ("FTT") ruled that the transfer of business assets to an entity who is a member of a VAT group, and who will only make supplies to other members of the VAT group, cannot be considered to be a Transfer Of a Going Concern ("TOGC") for VAT purposes.

This is both an interesting and unusual case as it appears to be the first reported decision which provides guidance on how the VAT grouping provisions and TOGC conditions interact with each other in this type of fact pattern.

Background

As a general point, if business assets are being transferred from one entity to another and certain conditions (as set out in VAT legislation and HMRC guidance) have been met, it is often clear that a TOGC has taken place. The result, and subsequent benefit, of establishing that the TOGC rules apply is that, in addition to the contract price, the transferee does not suffer a VAT charge of 20% (which might represent an absolute or cash flow cost depending on the transferees VAT status).

However, in more complex scenarios such as that in the case concerned, it can be very difficult to determine whether a transaction can take place "VAT-free" as a TOGC. HMRC will generally not rule on the matter so the vendor is left to make the decision on whether or not to charge VAT on the sale. The TOGC provisions are not optional and must be applied where appropriate. Accordingly, the FTT's decision is helpful in providing clarification in this area, although it is limited to the specific fact pattern of the case.

Implications

This decision affects businesses who are currently buying in third party services but who later plan to acquire the assets of the service provider – an "in source". The decision makes it clear that where the transferred business will solely supply fellow VAT group members following the acquisition (i.e. it only undertakes transactions which are disregarded under the VAT rules), TOGC treatment will not apply and the sale will be within the scope of VAT. This will normally be clearly evidenced within the Sale and Purchase Agreement. Where the purchaser is able to fully recover VAT charged then it is only the cash flow that is relevant. However, where the purchaser is partly exempt, VAT may be a cost. Particular attention should be given to the anti-avoidance rules which require a partly exempt purchaser in a VAT group to self account for VAT on the purchase of a TOGC (effectively bringing part of the TOGC transfer back within the scope of VAT). However, the rules are complex and, as such, may not produce a VAT cost equivalent to that charged on an asset transfer.

Final comments

Although the FTT decision is not binding, it does offer some clarification regarding the VAT treatment of more complex transactions and should be borne in mind when considering an acquisition or disposal of a business. Overall, it is important that transferors are aware of the consequences of charging, or indeed not charging, VAT. If the latter occurs and the correct amount of VAT is not accounted for this may lead to penalties. Conversely, transferees will not want to be levied with a 20% VAT charge that they were not expecting and which in certain circumstances may make, or break, a deal.

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Initial Public Offerings ("IPOs") – Preparing for an IPO

Companies are listing on the London Stock Exchange ("LSE") in ever increasing numbers. 2013 saw IPOs on the LSE at a six-year high, and in the first quarter of 2014, there were 11 IPOs on the main market (the companies had a combined value of £4.2bn and the IPOs raised £1.9bn) with 17 IPOs on AIM (the companies had a combined value of £3bn and the IPOs raised £1.2bn). This is more than twice the number of IPOs than in the same quarter of 2013. Other markets are experiencing similarly positive activity.

There are three principal reasons for companies looking to the public markets: to provide an exit for existing shareholders (particularly institutional / private equity shareholders), to raise cash to reduce existing borrowing, or to raise new funds for expansion – or a combination of all three. The structuring of the precise cash flows on the float will need to accommodate all three aspects (as appropriate) and also provide funds in the right entity for the settlement of other costs associated with the transaction (deal fees, stamp duty, etc). There are of course many other, sometimes less tangible, reasons why a company may wish to float, such as raised profile, possible access to future capital and employee incentivisation.

A float involves many different parties who are all focussed on a successful float of the group, headed by the issuer. These parties can include underwriters, brokers, sponsors, nomads, accountants, lawyers, investor relations advisors and many more. The documentation involved can also seem bewildering and includes the Prospectus / Admission Document, a Long Form report, a Short Form report, a Financial Reporting Procedures report, a Working Capital report, comfort letters, Board memoranda – the list goes on. However, there are tax implications that will need to be considered in respect of each of these.

In preparing for an IPO, and identifying tax issues which may arise, the company (and its advisers) needs to address the key question: "is this a priority area for the Sponsor or the Investor". With the answer to this question in mind, this article sets out some of the key tax considerations when preparing for an IPO.

Sponsor's priority areas – tax profile of company

The decision to float can provide an impetus to review tax compliance across the group to resolve outstanding issues; bring compliance matters up to date; formally assess and document tax control/risk procedures; and to consider the group's wider tax strategy to the extent that this is not already done. All of these actions will improve the overall message provided by the Long Form (due diligence) report which will assist the Sponsor in obtaining comfort that tax risks and uncertainties are being managed and that historical tax matters are under control, providing a more certain starting point for the cash flow forecasts required for the Working Capital report.

Investor's priority areas – structure of the company

There are several areas of the structure that will likely be of interest to Investors.

The review of the historical position will not only facilitate the resolution of material tax disputes (avoiding the need to refer to them in the Prospectus made available to potential Investors) but it will also enable the identification of tax attributes that need to be managed and preserved throughout the process, such as tax losses (bearing in mind a change of ownership can cause losses to be forfeited in some circumstances). It also provides useful insights that should assist in the analysis of the tax implications of the transaction itself. Watch out for the next edition of *M&A Tax Matters* which will pick up on this theme in more detail.

The group structure should also be considered at this stage from both a commercial / financial position, and from a tax perspective, particularly if the purpose of the float is to raise funds for international expansion.

Another key concern, although not a tax issue, will be the existence of negative reserves in the corporate structure which can impinge on the group's ability to flow dividends up through the structure to provide a post-IPO dividend return to shareholders. This issue can be particularly acute in PE-backed groups that have been highly leveraged and debt funding has created P&L losses in the holding company structure. It may be possible to, for example, move operating companies to sit directly below the holding company, and by-pass the companies with negative reserves, but such restructurings require care to ensure that they do not create other issues.

If the new funds raised by the float are to be used to acquire new companies overseas, the group structure needs to be considered in advance so that it can be ensured that the structure underpins the business objectives of the listed group, and that the funds can be moved flexibly around the group with minimal tax leakage to deliver those objectives.

As can be seen, there are a large number of tax-related issues to be considered in advance of a float for both the Sponsor and Investor. However, it should not be forgotten that in undertaking the role of Sponsor, the possibility of also becoming an Investor is inherent. Sponsors will also therefore keep a close eye on those issues generally considered 'Investor priority areas'. In the next edition of *M&A Tax Matters* we will consider some of the common pitfalls encountered during the IPO process itself.

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OECD Action Plan on BEPS

On 19 July 2013, the OECD released an Action Plan on Base Erosion and Profit Shifting ("BEPS") which was presented to the meeting of G20 Finance Ministers in Moscow. Within the EU, a similar initiative is being undertaken by the European Commission aimed at combating Tax Evasion, Tax Avoidance and Aggressive Tax Planning. Together these are the most significant multilateral initiatives for modifying international tax rules in recent times.

Although cross-border M&A transactions are not a specific focus of any of the proposed measures, it is very likely that the broad principle based changes will have an impact on the tax treatment of related investment structures.

The focus of the EU initiatives and the OECD Action Plan is "to prevent double non-taxation, as well as cases of no or low taxation associated with practices that artificially segregate taxable income from activities that generate it". The OECD Action Plan indicates that "no or low taxation is not *per se* a cause for concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it".

The deliverables of the EU and OECD Action plan are likely to be "soft law" instruments, recommendations on domestic legislative changes (e.g. hybrids or interest deductibility), to agree on a common interpretation of the arm's length principle, a new Model Convention, the definition of PE and / or to agree measures to improve Dispute Resolution.

In the previous edition of *M&A Tax Matters*, Adrian Crouch discussed hybrids and the EU Parent Subsidiary Directive. Double non-taxation, or arbitrage, plays off different tax rules in different countries usually through the use of 'hybrid' financing instruments or 'hybrid' entities in cross border investment structures and the EU and the OECD are looking at measures to neutralise the effects of such 'hybrids'.

The EU and the OECD are also looking at the implementation of additional anti-abuse provisions such as General Anti-Avoidance Rules ("GAAR"), Controlled Foreign Companies ("CFC") rules, subject-to-tax clauses, limitation of benefits clauses and other provisions which may be adopted in tax treaties for the purpose of avoiding tax treaty shopping. This may mean that cross-border investment structures that have traditionally been used and been readily understood by the market will require additional restructuring to strengthen the level of substance or the amount of taxes paid in a specific jurisdiction. Richard Watson and David Gordon discuss Action 6 (treaty benefits) in more detail in the following article.

In future editions of *M&A Tax Matters* we will continue the series on the BEPS Action Plan covering such areas as; the increasing focus on interest rates on shareholder loans, margins realised on intermediary financing activities and the arm's length nature of investment and asset management services provided by related parties; as well as Country-by-country reporting which will require disclosure of key financial information, taxes paid, location of key decision makers and intra-group flows.

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BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances

Action 6 of the Base Erosion and Profit Shifting ("BEPS") initiative launched by the G20 in 2013 aims to prevent the use of international tax treaties to avoid tax and in particular to counter "treaty shopping" (i.e. routing transactions through third countries to access lower treaty rates of tax). If the proposals are adopted many cross border transactions will be significantly affected, resulting in less certainty of treatment and higher tax costs. This article focuses solely on the treaty shopping proposals of Action 6 for companies and the potential consequences for deal structures.

Proposals

The two main proposals are to include both a Limitation on Benefits Clause ("LoB") and a General Anti-Abuse Rule ("GAAR") into the OECD Model Treaty Provisions with the aim that these will also be applied to existing treaties.

(i) Limitation on Benefits clause

A LoB clause would restrict benefits only to "qualified persons", i.e. companies which are resident in the Contracting State where any income is received and which also meet one of a number of tests, being:

- public companies which are listed locally or managed and controlled locally in the State of residence; OR

- companies which are controlled by other companies (5 or fewer) that would themselves be qualified persons under the first test; OR
- companies which are controlled for more than half the year by shareholders that would themselves be qualified persons and where less than 50% of the company's gross income is paid (in the form of tax-deductible payments) to parties who would not themselves be qualified persons (this excludes arm's-length payments for services or tangible property made in the ordinary course of business); OR
- companies that have an active trade or business in the State of residence and where the income from the other Contracting State is part of, or incidental to, that business (this excludes the making of investments by the company on its own account).

The paper also proposes a "derivative benefits" provision whereby the company would be deemed to be a qualified person if: i) it is greater than 95% owned by 7 or fewer participators (equivalent beneficiaries). Meaning participators who would be entitled to equivalent benefits (i.e. the same or lower tax rates) under a treaty between their own state of residence and the state from which any income is derived. ii) less than 50% of the company's gross income is paid to persons who are not equivalent beneficiaries.

In other words, broadly there is effectively no benefit being obtained by being established in the Contracting State as it would be possible to achieve the same benefit by holding the asset directly.

If it did not qualify under any of the above provisions, a company could then apply to the Competent Authority of the Contracting State of which it is not a resident (i.e. the country from which any income would be received) to give a ruling that it was not established or maintained for the purposes of obtaining benefits under the treaty and so would be entitled to treaty benefits.

ii) General Anti-Abuse Rule (GAAR)

It is also proposed that a GAAR be introduced to treaties denying treaty benefits where "it is reasonable to conclude, having regard to all the relevant facts and circumstances, that obtaining that (treaty) benefit was one of the main purposes of any arrangement or transaction...unless it is established that granting that benefit...would be in accordance with the...purpose of... this Convention."

The GAAR would supplement the LoB such that, even where a resident met the requirements of the LoB, treaty benefits might still be denied if it could be shown that the transaction or arrangement constituted an improper use of a treaty provision. It is proposed that any GAAR would be supplemented by a detailed commentary and a number of practical examples to aid interpretation.

Comment

These provisions represent a significant tightening up of the rules around qualification for treaty benefits. While the LoB proposals appear to offer objective testing criteria and therefore more certainty, in practice, they can be difficult to work, representing a significant compliance burden as well as potentially denying treaty benefits in genuine commercial circumstances. It is also clear that the LoB approach in its current form would be highly problematic for many Private Equity funds and funds groups more generally given their ownership structures – further consultation is now being undertaken with a view to addressing this.

The GAAR, while less objective, could be easier to apply in practice, especially if it were backed up by detailed commentary and examples, together with a clearance procedure. However, there is a risk that there could be divergent approaches by Tax Authorities in applying any GAAR and this could create significant uncertainty.

From recent OECD meetings with stakeholders it is clear that there are likely to be some revisions to reflect taxpayer comments before the final proposals are published in September. One significant uncertainty remains; namely, how any proposals would be implemented in existing treaties given the size of the treaty network and the time it takes for negotiations to be concluded. However, the OECD is confident this issue can be overcome.

Given the step change in focus on treaty shopping and the ongoing consultation over the wide-ranging measures now proposed to counteract it, this is clearly an area to watch. In the meantime, deal makers should continue to ensure that the reasoning behind the adoption of any structure is clearly articulated and fully documented.

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Automatic Exchange of Information ("AEOI") impact on M&A transactions

On 13 February 2014, the OECD published a model Competent Authority Agreement ("CAA") and Common Reporting Standard ("CRS") in order to advance global automatic exchange of information ("AEOI"). Under AEOI participating jurisdictions, of which there are more than 40, will automatically exchange financial account information of non-resident account holders received from domestic financial institutions. The AEOI model is based on the Model 1 Intergovernmental Agreement ("IGA") to implement US FATCA, without the focus on US tax residents or withholding. AEOI does not yet have any legal force, but it is expected that participating jurisdictions will adopt the regime on short timelines with first reporting due in 2016.

Currently financial institutions are actively implementing US FATCA, including the IGAs, in order to be ready for the 1 July 2014 deadline. Many are still in the process of assessing the impact and changing procedures and systems to achieve compliance. In M&A transactions the potential impact of US FATCA is only starting to be assessed as the requirements are phased in over the next few years. Due diligence checklists are being developed to determine the FATCA status of each of the entities in the group being acquired and in the financial sector more detailed questions are being asked around the compliance process implemented and tested to date as well as any customer/investor due diligence process and status. Importantly, the US FATCA rules only permit reliance upon customer/investor due diligence done by the seller for six months after the purchase, so acquirers of financial businesses should be aware of the costs involved with the validation of customer/investor status. We expect that in the AEOI context that acquirers should be able to rely on the procedures carried out by the seller unless the customer/investor has a change in circumstance.

AEOI, however, raises further complications around the status of group entities being acquired, because these may vary from the US FATCA classification and deal teams will need to keep up with which jurisdictions are participating in AEOI. AEOI may be phased in these countries at different timelines as there are no fixed dates in the standard yet. Moreover, for purchases that involve the acquisition of financial entities in different jurisdictions – either groups or those within non-financial groups – AEOI will need to be looked at in each jurisdiction separately, as each jurisdiction is likely to have different AEOI partners as this regime is likely to be a series of multilateral and bilateral agreements entered into at different times.

Finally, AEOI is intended to be implemented in each participating jurisdiction under domestic law and there are many places in the CAA and CRS that allow jurisdictions options in applying the rules. This may lead to local specialists being required to fully assess sufficiency of the AEOI programs. Acquirers will seek to integrate targets' AEOI programs into their own programs, which may turn out to be a complex task due to the different procedures and interpretations of the requirements. Acquirers will be also looking to limit any exposure to the liability under the domestic law for any past non-compliance with the AEOI.

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US reverse triangular mergers

A reverse triangular merger is a common means by which a UK Parent may acquire a US Target (and, more recently, may form one of the steps required to achieve a US inversion via a European merger).

The steps involved are essentially:

1. UK Parent forms a new US subsidiary (Merger Sub);
2. The shares of US Target are cancelled;
3. US Target merges into Merger Sub with US Target being the surviving corporation; and
4. UK Parent issues shares to US Target shareholders as consideration for the cancellation of their shares.

From a commercial standpoint, there are two reasons for effecting a US acquisition in this way. First, the consent of only a simple majority of US Target's shareholders is needed (although dissenting shareholders can exercise 'appraisal rights' whereby instead of receiving shares in UK Parent they must be given the appraised value of their US Target shares in cash). Second, as US Target survives the merger, there is no transfer of assets or novation of contracts for which third party consents may be needed.

For any UK shareholders in US Target, capital gains rollover may be available via s136 and para 5 Sch 5AA TCGA, as the transaction is akin to a new holding company being inserted above US Target via a Companies Act 2006 scheme of arrangement.

A more difficult point arises regarding the position of UK Parent. Merger Sub ceases to exist as a result of the merger and its shares are automatically converted into shares in US Target as the surviving company. This conversion is not a reorganisation for capital gains purposes so there must have been a disposal of the shares in Merger Sub, but for what consideration? When the point was put to HMRC recently they indicated that the shares issued by UK Parent could be regarded as consideration for both the acquisition of US Target and the disposal of Merger Sub. An apportionment of the consideration would then be necessary but, since Merger Sub would typically have only nominal share capital, only nominal consideration would be apportioned to it so no gain should arise.

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Consortium relief and non-UK resident link companies

Felixstowe Dock and Railway Company v HMRC – The CJEU has released its judgement on this case which concluded that consortium relief is available pre-July 2010 notwithstanding that the link company is not a UK resident.

In this case, several UK companies which are indirect subsidiaries of Hutchison Whampoa Ltd (a Hong Kong company) have sought to claim consortium group relief on losses surrendered by Hutchison 3G UK Ltd (a UK company) which is owned by a consortium which includes Hutchison 3G UK Investment Sarl (a Luxembourg holding company) which is an indirect subsidiary of Hutchison Whampoa Ltd.

The claims were denied by HMRC on the basis that the Luxembourg holding company, being the "link company" for the purposes of the consortium group relief, was not a resident in the UK.

In their judgement, the CJEU has observed that a difference in treatment arose where consortium companies have a relationship with a UK link company vis-a-vis a link company established in another member state. As this difference in treatment was not justified by any objective to preserve a balanced allocation of powers of taxation between the member states or to combat purely artificial arrangements, the CJEU concluded that this constitutes a restriction on freedom of establishment and ruled against HMRC. In arriving at the conclusion, the CJEU has considered that the provisions of EU law do not impact a company's right to freedom of establishment where their ultimate parent company and other intermediate companies were established in third states. Furthermore, the UK legislation applicable to consortium relief at the time is silent on the residence of the parent and intermediate companies. When UK consortium relief rules were changed to allow EEA companies to be "link companies" (from 12 July 2010) this principle was also reflected in UK law.

The above judgement is welcomed for companies that have made consortium relief claims before 12 July 2010 where the link company is an EEA resident. Any companies who have made claims or were in a consortium via a non-UK link company should review the status of their claims and consider whether relevant computations can be amended. From a transactional perspective, given the periods involved are now relatively historic, it will be important to confirm appropriate due diligence is undertaken around this area to ensure potential claims are identified during the deal process.

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Transitional provisions concerning fixtures are at an end: implications from a transaction perspective

Fixtures

Finance Act 2012 introduced important changes to the rules on second-hand fixtures within property. In summary, the availability of capital allowances to a purchaser of second-hand fixtures is conditional on two main factors:

1. the vendor pooling the relevant expenditure prior to sale, and
2. both the seller and purchaser:

a. formally agreeing a value for fixtures within two years of the sale through a joint election, or

b. commencing formal tribunal proceedings to agree the value within that time.

It is worth noting that specific provisions apply where the seller is outside the charge to UK tax, such that you may be required to make enquiries of the owner of the property prior to the current seller. It should not just be assumed that because the prior owner was not able to pool the expenditure you are not within the new fixtures rules.

You may be aware that transitional provisions existed such that the pooling requirement did not need to be met. This transitional provision came to an end from 1 April 2014 for corporation tax and 6 April 2014 for income tax. As such, this is a critical issue for entities looking to buy or sell property going forward to ensure that they are realising the full value of their assets.

From the seller's perspective, even if capital allowances claims have been ignored in the past (perhaps due to the availability of losses), this is no longer an excuse for not pooling the relevant expenditure where a future sale is anticipated. Failing to comply with the rules could significantly erode the commercial value of the property as a whole.

From the purchaser's perspective, appropriate pressure may need to be brought to bear on the seller to ensure that any future claim for allowances are protected, and swift completion of the claim may be required in order to comply with statutory provisions and any relevant warranties within the purchase contract.

It is also important for both sides to ensure that the contract documentation is appropriately worded such that it is compliant with the new rules.

Issues on merger/acquisition

Capital allowances are often a key consideration in a transaction either due to the large numbers involved or the potential issues with risk management and sign-off for the SAO of an acquiring company. We have

highlighted below some current issues to be considered when considering a transaction.

Processes and controls

We are now within the age of risk based reviews by HMRC and increased burdens on companies to document their processes and controls, including within those processes, to identify errors.

This can be a complex and time consuming task, requiring a significant amount of work on the parts of both the property and finance teams within an organisation. However there are ways in which this can be simplified through standardisation of processes and software solutions.

But what happens when you acquire a new company or a sub-group?

This coming together presents both opportunity and risk.

The opportunity now exists to consider your fixed asset processes and systems and whether they are really providing you with all the information and answers you require. Are you able to use them for effective forecasting? Could time and cost be stripped out of the process?

The risks are that you may be acquiring a company who previously benefited from an agreement with HMRC which simplified their claim process, which becomes invalidated as a result of the change of ownership, necessitating further work. In this situation the company may also lack access to the detailed cost information you require to undertake a detailed review of their capital expenditure, or bring them within your existing processes and provide comfort from an SAO perspective.

Existing Agreements with HMRC

If you or your target company have a current sample based percentage agreement for instance, does your agreement with HMRC allow for the instance of purchasing another business? Do you now need to renegotiate your agreement as a result of the acquisition? Has the spend profile of your target company diluted that of your existing brands?

It may be possible to agree a pragmatic approach with HMRC to access the impact, if any, this will have, but to assume that the percentage agreement is valid in consideration of the acquisition without consulting HMRC could expose the group to penalties and would almost certainly have an impact on your risk rating with HMRC.

Reorganisations prior to sale

It is relatively common that, when preparing for a sale, a group will undertake some form of reorganisation to ensure that the parts they wish to sell are packaged together in the most appropriate manner. This is of course a good practice, but careful consideration should be given to any pre-sale reorganisation when assessing it from a due diligence perspective.

The changes to the fixtures rules will impact the availability of allowances and the inter-company transfer may result in the loss of allowances on the fixtures within a property, if the fixtures had not previously been pooled. This transfer will effectively bring to an end the ability to look back into the history of the company and claim allowances on the fixtures which may not have previously been pooled due to the availability of losses.

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Additional KPMG Publications you may find of interest are listed below

Weekly Tax Matters

Taxation of Cross-Border Mergers & Acquisitions

Previous issues of M&A Tax Matters

High-growth Markets Magazine

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