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M&A Tax Matters

Autumn 2015

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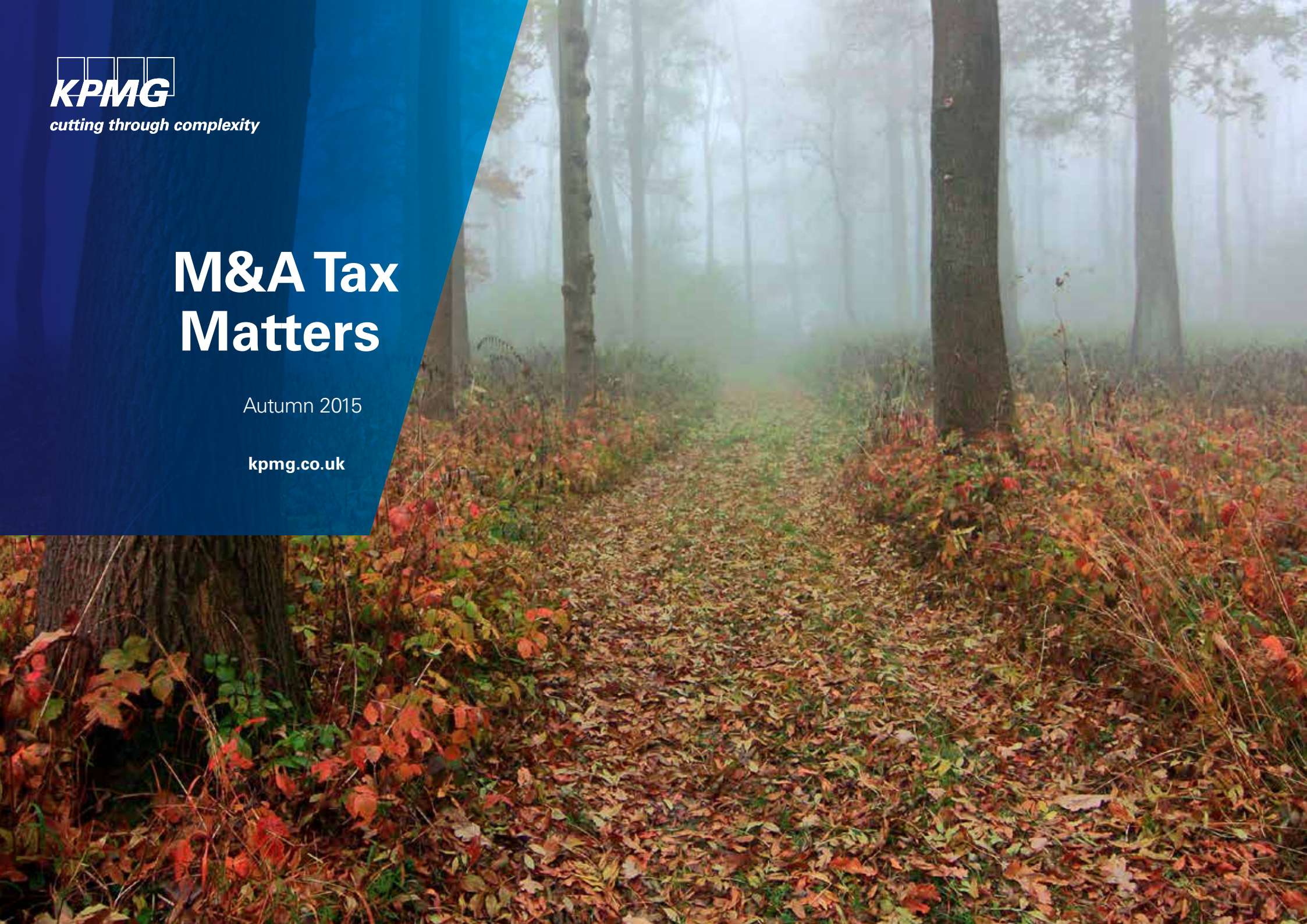

Welcome to the autumn edition of M&A Tax Matters

Kicking things off in our autumn edition of M&A Tax Matters, Paul McCartney and James Whittle discuss the OECD's BEPS Action Point 6 regarding prevention of treaty abuse, providing us with an overview of current proposals and explanations as to why this is of particular importance for the Private Equity industry.

Rob Norris discusses the new restrictions on the utilisation of corporation tax losses, outlining the conditions which bring about the restriction and also recent changes to the utilisation of tax losses in the context of controlled foreign companies.

Graham Taylor then provides us with an update of the key changes to the taxation of carried interest, as announced in the 2015 Summer Budget, and how these changes might impact clients operating carried interest arrangements.

We then hear from our editorial team on the new EU General Anti-Abuse Rule for the EU Parent-Subsidiary Directive outlining the objectives, rules and implications for EU member states.

Iain Kerr and Hiral Bhatt then give us an overview of the recent case of *Anson v Commissioners for Her Majesty's Revenue and Customs ('HMRC')* which could potentially reopen the debate about opacity versus transparency of foreign entities.

Turning to VAT, Kevin Carletti, Carine Epardaud and Anthony Harb give us an overview of the recovery of VAT on transaction costs in light of anticipated HMRC guidance updates.

Next, we enter into the world of stamp taxes where Sean Randall and Ginny Offord give us their view on HMRCs new definition of 'stock' for the purposes of corporate restructurings and how this affects stamp duty relief on acquisitions.

Closing out this edition, we consider provisions that were announced in the 2015 Budget, which came into effect on 8 July 2015, to prevent a trade and asset deal from obtaining amortisation or impairment relief on goodwill and certain consumer related intangibles. Paul Harden and Iain Kerr talk us through these new restrictions, outlining specifically what assets are effected by the new rules.

We hope you will enjoy our autumn edition of M&A Tax Matters. If you would like further detail on the articles in this, or any previous issue, please call us, the authors, or your usual KPMG contact.

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BEPS Action Point 6: Impact for Private Equity funds

On 19 July 2013 the Organisation for Economic Co-operation and Development ('OECD') published its action plan on Base Erosion and Profit Shifting ('BEPS'). The action plan identified 15 key actions to address the issue of BEPS. Many of these actions are of interest to the Private Equity industry with one of the most relevant being Action Point 6 - Preventing the Granting of Treaty Benefits in Inappropriate Circumstances (often referred to as treaty shopping).

Why is treaty access relevant to Private Equity funds?

Private Equity funds exists to aggregate and deploy capital to generate investment returns. A feature of Private Equity funds is that they are generally established as fiscally transparent vehicles (a Limited Partnership is a common choice of vehicle for UK managed funds) to provide for flexibility in distributing cash and to avoid a layer of fund level taxation on investment returns.

However, Private Equity funds structured as fiscally transparent entities are generally not able to avail themselves of tax treaty benefits as, for treaty purposes they are often not considered tax resident in their jurisdiction of establishment. This can mean that investment returns are potentially exposed to taxation in the source jurisdiction.

Ultimately many of the investors in Private Equity funds may be institutions with wide treaty access who would not be exposed to the same level of local taxation if they had participated in the investment directly. While such investors may be able to recover investment level tax suffered by making separate treaty claims, the process can be administratively burdensome and there can be a significant time lag between when the tax is suffered and the subsequent refund by the local tax authority.

Therefore for many Private Equity funds the mix of considerations in determining the jurisdiction of an investment holding company will typically include the quality of the tax treaty with the investment jurisdiction. If there is a favourable treaty and the holding company is treaty qualified then the risk of tax leakage/administrative burden of reclaims for investors is reduced or mitigated.

Current treaty position

Tackling genuine abuses of tax treaties is not a new topic. The current version of the OECD-Model Convention (on which most tax treaties are based) and the associated commentary provide for a number of anti-abuse provisions which may be included in bilateral treaties (for example the beneficial ownership requirement which attaches to certain income flows).

In addition many countries have implemented anti-abuse rules in their domestic tax law to prevent the application of tax treaties when the direct recipient of a specific item of income has no substance or is not considered as the beneficial owner of such income.

While the existing position is not perfect, it is generally well understood and there is an acceptable framework that Private Equity funds can work within to deliver an equitable result for their investor base.

Key proposals of BEPS Action 6

The BEPS Action 6 working group have proposed that treaty abuse is tackled by modifying existing tax treaties so that they are less susceptible to abuse.

Context

Before examining the proposals as they currently stand it is worth pausing to consider the Action 6 working group's brief.

The key focus of the BEPS project is to prevent perceived abusive tax practices by large multinational organisations, and as such most of the proposals emerging from the project are focused on this issue. While the OECD has shown a willingness to engage on areas where proposals have a negative effect on practices of other industries which are not obviously abusive, it is clear that the September 2015 deadline they are working towards is a tight one; there is a sense that their focus for this deadline is on getting the proposals in shape to address their primary brief. Where specific industry carve outs and modifications are required the OECD has been open to continuing the process into 2016.

The current position of BEPS Action 6 is a good example of this – the draft proposals as they stand are problematic for the Private Equity industry and while the OECD has been open to discussing the industry's objections, a full dialogue on these points has been delayed until 2016.

Current proposals

Various modifications to tax treaties have been proposed and debated over the course of three discussions documents (March 2014, November 2014 and May 2015) with the current proposal being to provide four options of clauses to insert within tax treaties (with individual jurisdictions choosing which approach to follow).

1. A Limitation on Benefit (LOB) clause with a Principal Purpose Test (PPT).
2. An LOB clause with an anti-conduit rule.
3. A simplified LOB clause combined with a PPT.
4. A standalone PPT.

It is difficult to predict what the ultimate take-up of each of these options will be, or indeed whether these options will be further refined before the work is completed. That said, we consider it likely that most jurisdictions will adopt the PPT, with relatively few adopting the full LOB – the US being one jurisdiction which is very likely to adopt full LOB.

All four options provide for some combination of a LOB, Simplified LOB or PPT clauses. Each is explained briefly below:

LOB clause

LOB clauses can already be found in tax treaties (most notably those concluded by the US). An LOB clause would introduce the concept of a 'qualified person', with only qualified persons passing the existing anti-abuse provisions able to access treaty benefits.

The criteria for what constitutes a qualified person are fairly detailed and focus on the activities and/or ownership of an entity. For a company to be a qualified person, broadly it must be either:

- Listed;
- Carrying on a trade in its jurisdiction of residence; or
- Controlled by qualified persons in the same jurisdiction.

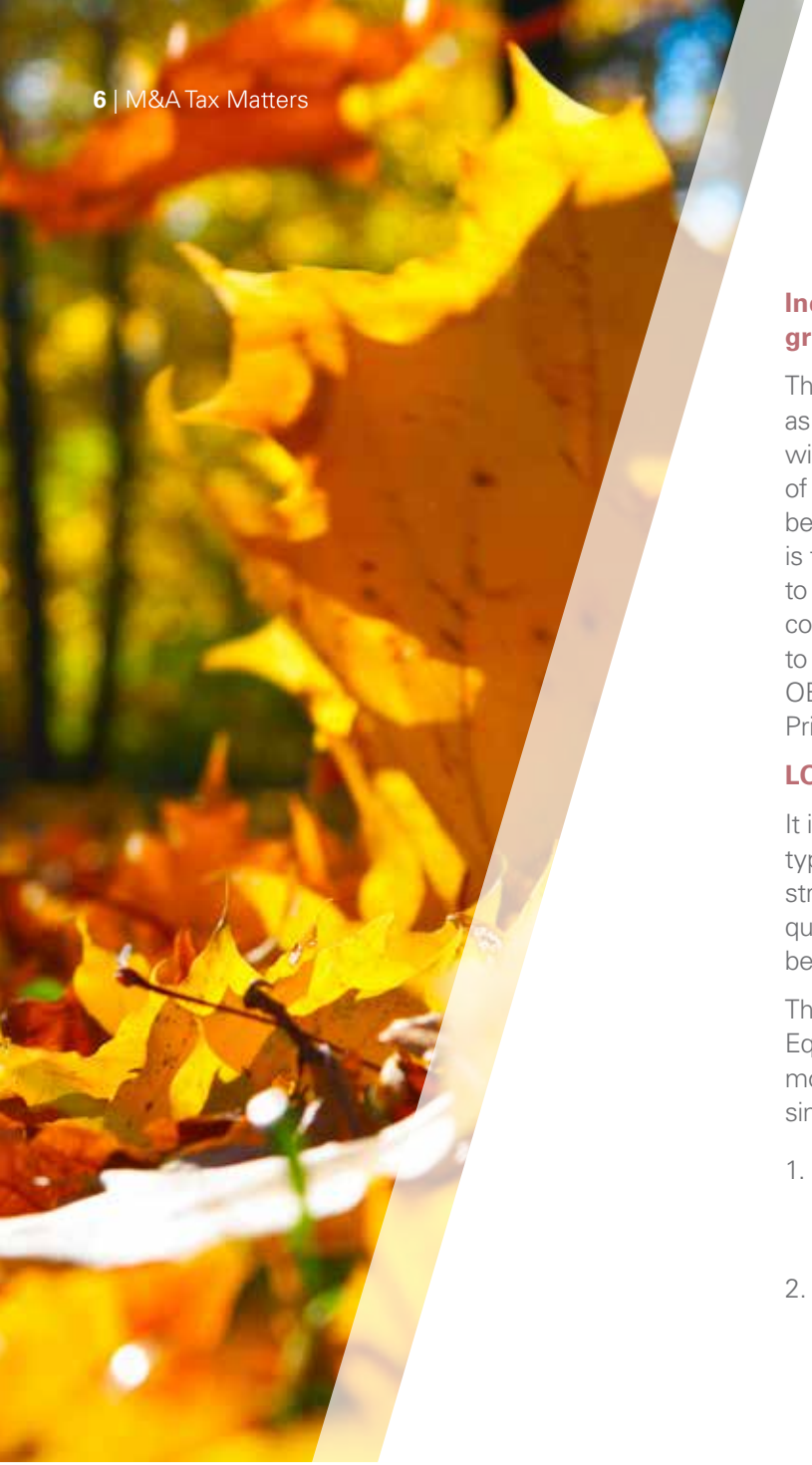
Simplified LOB clause

The proposed simplified LOB clause would mirror the LOB clause discussed above but include an additional derivative benefits provision. The Simplified LOB clause would be combined with a PPT (discussed below).

The derivative benefits provision as proposed would allow an entity which is not otherwise a qualified person to pass the LOB test where it is beneficially owned by more than 75% 'equivalent beneficiaries' - broadly other treaty qualified entities who would be entitled to an equivalent or more favourable treaty benefit if they participated in the arrangements directly (referred to hereafter as 'good treaty' investors).

PPT

The PPT is a general anti-abuse rule which will operate to deny treaty benefits if one of the main purposes of the underlying arrangements is allowing access to treaty benefits.



Industry dialogue with the BEPS Action 6 working group

The Private Equity industry, led by industry bodies such as the BVCA, EVCA, and PEGCC has actively engaged with the BEP Action 6 working group over the course of the project to date. Throughout the dialogue it has been stressed that the desired outcome of discussions is to avoid a situation whereby pooling investment leads to greater tax costs/uncertainty of returns for investors compared to if they were to invest directly. In responses to the latest discussion draft it has been made clear to the OECD that all three proposed options are unhelpful for the Private Equity industry, as discussed below.

LOB and Simplified LOB options

It is quite clear from the base LOB requirements that a typical holding company in a Private Equity investment structure would be unlikely to meet the definition of qualified person and as such would be denied treaty benefits with respect to jurisdictions adopting this clause.

The simplified LOB, while appearing helpful to Private Equity funds (a holding company owned by a fund with more than 75% good treaty investors would pass the simplified LOB), is almost as problematic for two reasons:

1. The in-out nature of the test is unhelpful e.g. a Private Equity fund with 75% good treaty investors could still be denied treaty benefits in full.
2. The test would likely be time consuming and costly to monitor for PE funds.
   - PE Funds investing across a range of jurisdictions would need to keep track of each ultimate investor's treaty position on a jurisdiction by jurisdiction basis.
   - Existing fund level information on investors may not extend to the ultimate treaty beneficiaries (e.g. for a fund of funds investor its investor base would need to be assessed for treaty access) and indeed the fund may not have the power to obtain the information required.

These points have been made to the BEPS Action 6 working group and the concern expressed that if these clauses are widely adopted good treaty investors may be deterred from pooling their investment in Private Equity funds.

With the industry concerns in mind it has been requested that Private Equity funds are either i) carved out from the LOB and Simplified LOB rules or ii) defined as a separate class of qualified person.

In the latest discussion draft the BEPS Action 6 working group proposed that certain regulated funds are defined as a qualified person however they have currently elected not to extend the definition to non-regulated funds such as Private Equity due to treaty shopping concerns. It has not been made clear what these concerns are and the industry has requested clarification on this point.

PPT options (both standalone and combined with LOB/Simplified LOB)

The concept of a PPT has been broadly supported by the industry as a useful tool for preventing genuinely abusive activities. However concerns have been expressed that, because the test is so subjective, where the PPT is adopted it may exacerbate inconsistency in how different jurisdictions apply treaty provisions.

With this in mind it has been recommend that the PPT is re-drafted to be a test of the single principal purpose of the arrangements.

Further the industry has submitted Private Equity specific examples for inclusion in the model commentary illustrating situations where it is proposed that the PPT will not apply. There has been no feedback as yet on either of these points.

Other points to consider?

It is worth bearing in mind that the EU Interest & Royalties Directives and EU Parent Subsidiary Directives are not formally part of Action 6. Both directives have recently been updated to include general anti-abuse provisions with the Parent-Subsidiary also being amended so that the dividend exemption for payments on hybrid instruments is removed. For EU focused funds it will be important to consider these directives as part of any discussion on Action 6.

What next?

BEPS Action 6 is due to complete in September 2015, however as noted above the working party has acknowledged that discussions with respect to unregulated funds will continue into 2016. It is hoped that that the OCED will acknowledge that Private Equity funds are not vehicles for tax avoidance and that they will accept appropriate amendments to the existing proposals.

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New restrictions on the utilisation of tax losses

The pre-election Finance Act and summer Finance Bill have introduced new restrictions on the utilisation of corporation tax losses. These changes will need to be considered as part of the due diligence on prospective acquisitions and in the context of post-acquisition structuring to utilise losses. The changes are part of a trend in recent legislation whereby the headline rate of corporation tax is being maintained or lowered but the tax base is widened via measures labelled as countering avoidance.

Targeted anti avoidance rule to prevent loss refreshing applying with effect from 18 March 2015

On 18 March 2015, legislation was introduced, applying with immediate effect, to counter tax motivated arrangements being used to refresh tax losses; where brought forward tax losses are turned into current year deductions which can be used in a more flexible manner, e.g. surrendered as group relief to be offset against the profits of other group companies (new Part 14B CTA 2010).

The provisions apply to arrangements entered into at any time but only to profits that arise on or after 18 March 2015. Periods which straddle this date must be split, with profits apportioned on a time basis unless this would be unjust or unreasonable (paragraph 4 Schedule 3 Finance Act 2015). The form of the commencement provisions means that it is necessary to test arrangements that have been entered into previously to assess whether the restrictions now apply. The scope of due diligence reviews will need to identify relevant arrangements which may have been implemented some years earlier.

If the provisions apply, a company will not be able to offset certain carried forward tax losses against profits arising from the arrangements but otherwise the losses remain available to be utilised. The provisions do not impact on the new deductions created by the arrangements.

The reason given for introducing the measure is that it "… will prevent companies from obtaining a tax advantage by entering into contrived arrangements to convert brought forward losses in to more versatile in-year deductions" (press notice of 18 March 2015). However, the measure is likely to apply to planning which has hitherto been regarded as acceptable. For example, HMRC's debt cap guidance includes the following.

"… suppose a particular company in a group ('company B') has a non-trading loan relationships deficit brought forward. Without the debt cap, company B might lend money to another group company ('company A') at a commercial rate of interest. Company B has interest income, against which the loan relationships deficit may be set, while company A has loan relationships debits that can be offset against its profits of the accounting period. Planning of this sort, designed to utilise reliefs in the most efficient way, is widespread and has never been regarded as particularly offensive by HMRC." (CFM92210)

Going forward, the type of planning described here could now be characterised as contrived avoidance arrangements such that the losses carried forward cannot be offset against the interest income.

The rules to counter loss refreshing apply if all of five conditions are satisfied. These are considered in turn.

A. Do the arrangements create profits which are sheltered by losses brought forward?

Condition A is that a company has profits which arise as a result of any arrangements (the "tax arrangements") and the company would, apart from the new rules, be entitled to deduct relevant carried forward losses from the profits for the period (section 730G(2) CTA 2010).

For these purposes, relevant carried forward losses are trade losses, non-trade loan relationship deficits and management expenses, with the latter including losses made by a company with investment business which has ceased to carry on UK property business (section 730F(1) CTA 2010).

Losses which are not affected by the rules include carried forward losses of a UK property business which can be offset against total profits of later periods, carried forward losses of an overseas property business which can be offset against profits of that business only and carried forward capital losses.

B. Do the arrangements create new in year losses or deductions?

Condition B is that the company which has the carried forward losses, or a connected company, brings into account a deductible amount and it is reasonable to assume that neither the company, nor any company connected with it, would have brought that amount into account as a deduction for that period but for the tax arrangements (section 730G(3) 2010).

An HMRC Technical Note gives an example where this condition would not be satisfied. There is an intra-group transfer of a trade to a company with substantial carried forward losses and Condition B is not satisfied because the arrangement has not generated a new deduction (Arrangement 4 HMRC Technical note 18 March 2015).

Although not covered in the Technical Note, the answer may well be different if the consideration for the transfer of trade is left outstanding on interest bearing inter-company account such that the arrangement creates a deduction for the interest expense. It does not seem to matter that the corresponding interest income is not sheltered by losses. In these circumstances, it will be necessary to consider the other conditions.

C. Is the main purpose of the arrangements to create profits and new in year deductions?

Condition C is that the main purpose, or one of the main purposes, of the tax arrangements is to secure a relevant corporation tax advantage for the company with carried forward losses and connected companies, taken together (section 730G(4) CTA 2010).

For these purposes, a "relevant corporation tax advantage" means a corporation tax advantage involving the deduction of any relevant carried forward losses from the profits arising from the arrangements (referred to in Condition A) and the deductible amount (referred to in Condition B).

Whether this condition is satisfied will be a question of fact determined, in part, by contemporaneous evidence of purpose.

D. Is the anticipated tax advantage more than the anticipated value of any other economic benefits to the arrangements?

Condition D is that, at the time when the tax arrangements were entered into, it would have been reasonable to assume that the tax value of the tax arrangements would be greater than the non-tax value, assessed with reference to the company with the carried forward losses and connected companies (section 730G(6) CTA 2010).

This condition has some similarities to the insufficient economic substance condition in the Diverted Profits Tax rules which compares the non-tax benefits from transactions/arrangements with the financial benefit of the tax reduction (section 110 Finance Act 2015). In each case, whilst, superficially, the conditions require an objective comparison to be made of the tax with the non-tax benefits, as a practical matter, it may be difficult and time consuming to quantify the benefits.

An HMRC Technical Note gives an example where this fourth condition is not satisfied. Equity funding is provided to a subsidiary with a substantial non-trade loan relationship deficit carried forward which on lends to another group company which uses the funds to make a third party acquisition. The interest on the loan is sheltered by the carried forward losses. It is said that Condition D is not satisfied because "The main economic driver and its largest anticipated benefit – is the opportunity to generate profits" (Arrangement 2 HMRC Technical Note 18 March 2015).

Whilst each case would need to be considered on its own facts and circumstances, it seems likely that the same analysis would follow for a loan to fund third party expenditure (e.g. a construction of a new factory) which would have been incurred irrespective of the opportunity to utilise tax losses. Although such an asset may not itself generate profits, it would form part of the asset base of the business from which profits are generated.

It would seem reasonable to conclude that the anticipated economic benefit from incurring the third party expenditure exceeds the tax benefit of sheltering the interest on the borrowing to fund that expenditure.

It is, though, more difficult to see how the non-tax benefits for purely intra-group arrangements would be established.

E. Does the priority rule for banks and similar businesses apply?

Condition E is that the arrangements are not subject to an anti-avoidance provision which is relevant for banks and similar businesses (Part 7A CTA 2010, introduced by section 32 and Schedule 2 FA 2015). These rules, broadly, put a 50% limit on the amount of certain tax losses which can be offset against taxable profits with effect from 1 April 2015.

The purpose of this condition is give the banking anti-avoidance provision priority over the measure to prevent loss refreshing. If a company is not a bank or similar business, the fifth condition will always be satisfied.

Historic and proposed planning will need to be assessed to determine whether it is affected by the new restrictions. Provided that one of the conditions is failed, the arrangement will not be caught. This should be reasonably straightforward if there are no new deductions.

Controlled foreign companies – measures applying from 8 July 2015

The summer Finance Bill has made two changes to the utilisation of tax losses in the context of controlled foreign companies ("CFCs").

First, it is no longer possible to utilise losses of the UK group to shelter profits of a CFC which are apportioned to the UK water's edge company (section 371UD TIOPA is repealed by clause 35 Finance Bill). This is relevant, for example, for group relief, non-trading loan relationship deficits and management expenses.

The amendment has effect from 8 July 2015, with the profits of the CFC in the accounting period straddling this date being apportioned on a just and reasonable basis.

The effect of the change is that if a group is subject to a CFC apportionment, this will represent a tax cost even if there are tax losses, such as group relief, which are available to shelter current year profits. For example, suppose a company makes an upstream loan to the UK. Hitherto, the group might have accepted a CFC apportionment in relation to the interest income in the CFC and offset the interest expense in calculating the CFC charge. Going forward, the interest income of the CFC would be fully chargeable.

Second, the rules restricting the use of carried forward losses, described above, have been extended such that Condition C, which considers the main purpose of the arrangements, is now satisfied if one of the main purposes is the avoidance or reduction of a CFC charge (clause 36 Finance Bill 2015).

The amendment has effect for the purposes of calculating a CFC charge from 8 July 2015 onwards whatever a company's period end.

This can be seen as a protective measure as a consequence of the first CFC amendment in that it is no longer possible to offset UK losses in the calculation of a CFC charge. Without the second amendment, there might be a behavioural change by business such that internal group arrangements are entered into to reduce the profits of the CFC with the corresponding income in the UK being sheltered by losses, effectively circumventing the first amendment. This could, for example, be relevant if a UK company makes a loan to a CFC, with the finance expense reducing the chargeable profits of the CFC and the corresponding finance income being sheltered by losses carried forward.

We will have to wait and see if further restrictions are placed on the utilisation of tax losses.

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Investment Managers: Impact of the changes to the taxation of carried interest

In the 2015 Summer Budget George Osborne announced the government's intention to change the law to "make sure investment fund managers pay the full capital gains tax rate on their carried interest". The proposed rule changes sought to put an end to what is commonly known as 'base cost shift'. It is clear from the draft legislation and guidance that the impact of the rules extends far beyond their stated intention, particularly with respect to non-domiciled individuals, and as such certain consequences of the changes are already being felt. This article seeks to provide an update on the key changes and how they impact taxpayers operating carried interest arrangements.

Operation of the news rules

Rather than replacing the existing tax rules with a simple "flat tax", as some had assumed, the new rules operate alongside the existing framework, effectively adding a new tax for investment managers with scope for double tax relief.

For the past thirty years the taxation of carried interest has relied on the principles set out in Statement of Practice D12, which is the statement of HMRC's practice for dealing with capital gains arising on assets held by a partnership. Under these rules it was accepted that once carry became payable (usually when investors' capital has been repaid to them and the profit sharing ratios changed so that a proportion of the profits flow to the carried interest holders) an amount of base cost 'shifted' from the investors to the carried interest holders. This normally resulted in the carried interest holders receiving a larger economic profit than the amounts being subject to tax, as they would be taxed on a share of the gain arising on an asset rather than a share of the proceeds, notwithstanding that they had not contributed any of the original base cost.

The new rules look specifically at amounts arising to investment managers – very broadly, "amounts arising" means cash or equivalent, when the individual can access it. Where amounts arise to investment managers (on or after 8 July 2015) the entire amount will be taxed as if it were a chargeable gain, with certain relief for capital gains tax or income tax already paid (capped to the lower of the tax under the new rules and that paid under the existing rules). This means that amounts of dividend and interest income are unaffected by the rules changes and subject to regular rates of taxation, but creates a minimum tax rate of 28% (or 18% in respect of standard rate tax payers) on all receipts of carry where the investment manager undertakes his/her duties in the UK.

Interaction with the existing rules

As the existing 'base cost shift' rules have not been affected there are a number issues relating to how the new rules work alongside the existing rules. For example, where carry is held in escrow, some portion of the gain may be taxable at the point that the escrow operates, but may not arise to the investment manager for the purpose of the new rules until the cash is released from escrow.

Under standard capital gains tax principles, the investment manager would be liable to pay tax on their share of the proceeds, less the base cost that had been 'shifted' to them. Typically, under such circumstance we would expect a tax distribution clause to allow Executives to draw upon cash to pay their tax bills. However, such a drawing would constitute an amount 'arising' to them and place them within the framework of the new rules. The investment manager would then be subject to a tax charge on this amount too. Meanwhile the amount remaining in escrow may not arise (and be taxable) under the new rules until they are paid. The investment manager should eventually gain relief for all amounts already subject to tax but they face a complex additional compliance burden in order to ensure full credits are recorded and claimed accurately.

For investors in the fund, where profit sharing ratios change, base cost is still deemed to 'shift' to carried interest holders which lowers the base cost available for investors when calculating their own chargeable gains. Historically some carried interest holders have been willing to reimburse UK resident taxpaying investors for their lost base cost, however, given the changes to the rules this may no longer be commercially viable.

The rules as drafted could therefore effectively tax the same gain twice – once on the investors and again on the carried interest holders.

Investment managers will need to think more than ever about how returns are made to the carry and how this is best treated in the fund accounts and legal documentation.

Non-domiciled individuals and foreign gains

Another key change is that the rules provide that carried interest should only be treated as a foreign chargeable gain to the extent that the investment manager performs his or her services outside the UK. This significantly alters the position for non-domiciled individuals paying tax on the remittance basis, who often would not have previously been liable to UK tax on their carry.

To date, HMRC's guidance has stated that the proportion of gain to be treated as a foreign chargeable gain will need to be apportioned on a just and reasonable basis. HMRC have confirmed that they expect individuals to adopt a commercial approach and that they recognise that this doesn't necessarily mean a straight days count. Specifically they identified that time spent by an investment manager fund-raising overseas or working with embedding a new management team in an overseas portfolio company is likely to be of more value than time spent performing administrative roles in a London office. Conversely they questioned whether time spent attending board meetings in tax efficient jurisdictions would be particularly valuable.

Another issue for non-domiciled individuals will be how to track these amounts. Where carried interest consisting of a mixture of UK and non-UK and gains is paid, remittance basis payers will need to track amounts of UK gains that have 'arisen' to them, and therefore already taxed under the new rules, when deciding which amounts to remit to the UK. Non-domiciled carry recipients would therefore need to consider their tax position carefully.

Another particularly difficult area is relief for foreign taxes paid by a carry recipient. The position of UK resident US citizens is particularly complex, and is the subject of ongoing discussions between the BVCA and Treasury. Anecdotally we have heard of executives refusing to come to London as a result of these rule changes.

Definition of 'arise'

The application of the rules hinges on amounts 'arising' to individuals, the definition of 'arise' is therefore important in determining whether or not a tax charge is due. HMRC appear to have purposefully avoided a fixed definition of 'arise', presumably to avoid mischief. Our working understanding is that amounts arise when cash is received or cash is made available to draw by the investment manager. This raises a number of issues with regards to complicated structures such as if carry is paid to a personal holding company of an investment manager.

There is currently uncertainty regarding how to treat carry held by spouses. HMRC's initial guidance suggested that disposing of carried interest to a spouse would give rise to a market value tax charge but they have since conceded that this was wrong and such transfer would be at nil/gain nil loss. That being the case it is unknown whether carried interest paid out to an investment manager's spouse 'arises' to the investment manager for the purpose of the rules.

Leavers and warehoused carry

The rules also include provisions targeting the transfer of carried interest. Broadly, these rules state that amounts paid to an individual in respect of their carried interest, will be deemed to be a receipt of carried interest itself and therefore subject to the new rules. The wording of the legislation is unclear and there have been concerns that the rules will deem proceeds to be market value where no proceeds, or proceeds of less than market value are received by someone as consideration for their carried interest. If correct, this would have a significant impact on 'claw-back' mechanisms for bad-leavers, creating potentially very large dry tax charges on individuals moving between firms. Anecdotally we have heard of instances where senior executives have chosen to defer planned moves until more clarity on this point is available.

Conclusion

The updated legislation, revised guidance and ongoing dialogue with HMRC have made it clear that the consequences of the changes are considerably more complex than initially anticipated and there are a number of practical considerations that need to be addressed. Given the changes already made under the "disguised investment management fee" regime introduced earlier this year, every investment management client should be reviewing the overall strategy for executive pay and investment.

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The new EU GAAR: Considering the potential domestic impact

On 27 January 2015, the EU Council formally adopted a general anti-abuse rule (the "EU GAAR") that is now included in the EU Parent Subsidiary Directive 2011/96/EU ("PSD"). Member states have until 31 December 2015 to implement the new provision domestically which targets artificial and "non-genuine" tax planning by corporate groups. The EU GAAR has the potential to impact both new and existing cross-border EU structures, and careful consideration should be given to its potential application.

Background and objectives

Originally issued in 1990, the PSD aims to create a consistent system of taxation for distributions throughout the EU between parent and subsidiary corporates. Broadly, the PSD achieves this by exempting cross-border distributions by subsidiaries from domestic withholding tax ("WHT") and eliminating double taxation of the parent on the receipt of those distributions (either through exempting such distributions from tax or by providing a credit for tax already paid).

In certain circumstances, multinational groups that hold EU subsidiaries have been able to benefit from the PSD by structuring distribution flows through strategic cross-border arrangements. For instance, consider a non-EU parent holding an EU subsidiary that would normally withhold tax on dividend payments to a non-EU parent. By inserting a Maltese company (which falls within the PSD and domestically has no WHT on dividend payments, be it to an EU or non-EU parent) between the two companies, the PSD would apply to payments from the EU subsidiary and its new Maltese parent such that no WHT would also apply to the flow of distributions. There would also be no WHT on the payments from the Maltese company to the non-EU parent, hence a prevention of WHT leakage is achieved by taking advantage of the PSD.

In light of perceived instances of artificial structuring involving the PSD, the EU Commission put forward a proposal in 2013 to amend the PSD such that groups cannot artificially exploit its application.

The rules

The EU GAAR is focussed on the prevention of application of the PSD to holding structures that are not in alignment with the operational and management set-up of the group. The new rules state that:

"Member States shall not grant the benefits of the PSD to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the PSD, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part… An arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality."

It should be noted that the EU GAAR is designed to be a de minimis rule and individual Member States can apply firmer domestic rules.

Implications

The implications of the EU GAAR will be different for each EU member state, depending on the current standing of their own domestic rules.

Taking the UK as an example – dividends paid to a UK company from another EU company are not subject to WHT (by virtue of the PSD) and can also benefit from the UK's wide-ranging distribution exemption conditions (which are not available in certain circumstances, for example where there is a tax avoidance motive). Payments from the UK are also free from withholding tax (as there are no domestic rules imposing withholding taxes on dividends). Hence, no major changes should be required to the UK legislation as a result of the EU GAAR – the PSD is not taken advantage of for dividends paid from the UK, as the onus of withholding tax is on the member state paying the dividend to the UK and there are already specific UK anti-avoidance rules in s931B and s931J-Q CTA 2009 to counter tax avoidance motives for dividends paid into the UK.

Member states' domestic GAARs are increasingly being relied upon by tax authorities as a route to challenge a taxpayer's arrangements, even though the GAAR's original motivation may not have been designed for such challenges. The implementation of the EU GAAR may raise further concerns from taxpayers that the number of these GAAR-based challenges may increase, especially in light of the subjective nature of many of the rules – wording such as "main purpose" and "valid commercial reasons" are clearly open to interpretation.

Conclusions

Although the EU GAAR is only applicable to the PSD and in many cases there are already strict GAARs in place in member states, the EU GAAR's implementation may come as a further reminder of the EU Commission's determined efforts to counter perceived cross-border tax avoidance.

Groups will have to consider the amount of substance (i.e. employees, offices and management) in their holding structures so that they do not fall into the rules. Documenting decision making processes (such as structure papers) and the commercial reasons for choosing the location of holding companies may also form part of a valid defence against any EU GAAR challenge.

Ultimately, the practical implementation of the EU GAAR in member states should be on the agenda when determining future (and reviewing current) acquisition structures.

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The Anson case – what does this mean for M&A?

The recent decision of the Supreme Court in *Anson v Commissioners for Her Majesty's Revenue and Customs [2015] UKSC 44* has unsurprisingly given rise to a great deal of interest due to the implications this case has for both corporation tax and income tax purposes. From an M&A perspective, the decision in this case potentially reopens the long running debate about opacity versus transparency of foreign legal entities, which of course has a very real impact on the structuring of transactions. Perhaps inadvertently, the Supreme Court has, to a certain extent, increased uncertainty in an area which had become reasonably clear to M&A professionals, including the specific case of Deleware LLCs. The M&A tax team has previously obtained a number of clearances from HMRC which have now ceased to be the strong precedents they once were.

The Facts in Anson

For the periods 6 April 1997 to 5 April 2004, Mr Anson was a member of HarbourVest LLC ("HLLC"), a Delaware LLC which traded in Boston, Massachusetts, USA. HLLC's trade consisted of the management of a number of venture capital funds in which it had no economic interest. Mr Anson was entitled to 11.5% of the profits generated by HLLC.

HLLC's membership agreement stipulated that all profits of the HLLC were allocated to the members capital accounts on a pro-rata basis. Distributions of cash held by HLLC in respect of a calendar year would be carried out within 75 days of a calendar year end at the sole discretion of the managing member of HLLC (which Mr Anson was not). The same sole discretion applied to additional distributions that were made from time to time.

The First Tier Tribunal ("FTT") made the following interesting findings of fact in respect of the nature of a Delaware LLC based on comment by expert witnesses:

- A Delaware LLC is a separate legal entity, carrying out its own trade and owning its own assets
- The LLC bore its own liabilities, these did not attached to the members
- According to Delaware Law (s18-503 / s18-701 LLC Act), profits and losses of a Delaware LLC are allocated to its members as set out in the LLC's membership agreement.
- An interest in a Delaware LLC is "personal property" in of itself, the members do not have an interest in the LLC's own property.
- The interest of a member in a Delaware LLC was not similar to share capital, but to partnership capital in an English partnership

- The Delaware LLC Act provides that the interest of a member of an LLC includes his or her share of the profits and losses of the LLC

The FTT found that the fact that profits of HLLC were effectively automatically allocated to the members' capital accounts meant that the profits therefore automatically became the members' upon their recognition by the LLC, and that there was no intermediate step, analogous to a distribution, by which HLLC had to transfer profits to its members.

It found that this rendered the sole discretion noted above regarding cash distributions to the members irrelevant in terms of determining whether HLLC profits automatically became those of the members, and that the distributions under the HLLC members' agreement were mandatory, despite the existence of the sole discretion. In other words, the actual distribution of profits in cash was not the time when members became entitled to / owned profits, this happened as the profits arose.

Mr Anson paid US Federal withholding tax at an effective rate of 45% (including State taxes) on his share of HLLC profits, as determined under US Federal tax principles. He was then subject to income tax in the UK at a rate of 40% on his HLLC profits as calculated pursuant to UK tax principles. Mr Anson credited his US tax liabilities against his UK one, which is what gave rise to HMRC's challenge. HMRC was of the view that Mr Anson had effectively received a dividend and therefore was not entitled to double tax relief in relation to US Federal and State tax paid on HLLCs profits.

HMRC guidance prior to Anson

HMRC's published guidance on the opacity / transparency of foreign entities is set out in their International Manual INTM180010 - Foreign entity classification for UK tax purposes: Factors to consider in classifying a foreign entity for UK tax purposes

The guidance refers to the decision of the Court of Appeal in *Memec plc v CIR (70 TC 77),* which, prior to Anson, was considered the leading authority on the issue of opacity / transparency. This sets out the below list of tests relating to entity characteristics which should be used to determine, on balance, whether an entity is opaque or transparent:

a. Does the foreign entity have a legal existence separate from that of the persons who have an interest in it?

b. Does the entity issue share capital or something else, which serves the same function as share capital?

c. Is the business carried on by the entity itself or jointly by the persons who have an interest in it that is separate and distinct from the entity?

d. Are the persons who have an interest in the entity entitled to share in its profits as they arise; or does the amount of profits to which they are entitled depend on a decision of the entity or its members, after the period in which the profits have arisen, to make a distribution of its profits.

e. Who is responsible for debts incurred as a result of the carrying on of the business: the entity or the persons who have an interest in it?

f. Do the assets used for carrying on the business belong beneficially to the entity or to the persons who have an interest in it?

HMRC points out that factors c. and d. above are the most important determinants. It also notes that the following should be borne in mind in determining on a balance whether an entity is opaque or transparent:

g. The specific terms of the UK taxation provision under which the matter requires to be considered:

h. The provisions of any legislation, articles of association, by-laws, agreement or other document governing the entity's creation, continued existence and management, and;

i. The terms of any relevant Double Taxation Agreement.

HMRC's guidance on the issue on whether an entity has issued share capital (item b. above) was published in Revenue & Customs Brief 87/09 (RCB 87/09). This brief relies on a number of old cases, in particular *Ryall v. Du Bois Co. Ltd (1933) 18 TC 431, C.A.*

This brief advises that Delaware LLCs will normally have ordinary share capital and that HMRC considers that these entities have ordinary share capital for the purposes of the Taxes Acts.

Anson – The effect on Memec and on opacity versus transparency

The operative part of the Supreme Court's judgement in Anson focuses on a key question: under the Double Tax Treaty (DTT) between the UK and the USA, Mr Anson would be entitled to relief from US taxes on profits from a particular source where profits from that same source were also subject to tax in the UK.

The Supreme Court determined that the FTT's finding of fact meant that the profits on which Mr Anson was subject to tax in the US and the UK were from the same source. The LLCs profits were taxed in the US and, by virtue of the fact that these profits were deemed to be automatically allocated to the members of the LLC (11.5% in Mr Anson's case), these same profits were then subject to UK tax in Mr Anson's hands. DTT relief should have therefore been available to Mr Anson for the US taxes suffered.

The implication of the above rationale is that HLLC was fiscally transparent for UK tax purposes (despite the fact that Anson is concerned with income tax, it would be difficult to take the view that this transparency was anything other for than UK taxes on income generally). For UK tax purposes, Mr Anson was effectively treated as receiving trading profits from HLLC directly. Lord Reed quotes a particularly appropriate sentence from the FTT judgment: "[based on expert evidence] the members of [HLLC] have an interest in the profits of [HLLC] as they arise"

Some commentators have noted that Memec was not distinguished in the Anson judgement. It is not clear that this is the case, there are strong arguments that the Supreme Court did indeed distinguish Memec, and at the very least, it is clear that this case has not been overruled. In Memec, there were two members of a German stille Gesellschaft (SG), Memec GmbH (German tax resident) and Memec PLC (UK tax resident). Memec GmbH solely carried out the business of the SG, owned the assets of the SG and it alone was entitled to dividends received by the SG. Memec Plc was allocated SG income by virtue of the SG agreement. The Court of Appeal, in applying the tests noted above, found that an SG was opaque, crucially because it was not possible to conclude that the profits allocated to Memec Plc were the same profits arising in the SG. This was because Memec Plc had no rights over income, assets or any other value in the SG (in the language of Statement of Practice D12, no fractional ownership of partnership assets or income). In effect, Memec Plc received a distribution from the SG rather than owning profits of the SG as they arose.

Perhaps critically, the Supreme Court made the point that Memec was a case that related to a "tested entity" receiving dividends from owned subsidiaries, and whether those dividends were being treated as being received directly by Memec Plc, or whether Memec Plc was instead receiving a further distribution from the SG distinct from the dividends received by the SG. Anson was a case, as noted above, about whether the trading profits in the "tested entity" were the same as the profits on which the "tested entity's" member was taxed.

It is not clear where the issue of opacity versus transparency goes from here. The following conclusions are perhaps the most reasonable in the circumstances:

1. A German SG likely remains opaque as a default (these are a fairly uncommon option for German transactions so this is a reasonably unimportant issue).

2. A Delaware LLC likely defaults to transparent for UK tax purposes by virtue of the FTT's conclusion on the nature of Delaware law. This will certainly be the case where there are any provisions with the LLC membership agreement which suggest that LLC profits are automatically allocated to members. To overcome this default position would likely need express membership agreement terms suggesting that the LLC owns profits first and then specifically distributes profits to members.

3. For other entities classified as transparent or opaque for UK tax purposes by HMRC, as set out in International Manual INTM180030, as well as new entity types not yet classified, it might be necessary to consider both Memec and Anson simultaneously. Given that item d. in the Memec tests also places considerable importance on the criterion of whether members own profits as they arise versus on distribution of those profits, this test, i.e. the key Anson criterion, should be applied first, and only if there is considerable doubt about whether the tested entity automatically passes profits on to members or does so via an intermediate step akin to a distribution should the other Memec test be brought to bear. Item c. in the Memec tests assumes much less significance than it previously did because of the way this factor was dealt with in Anson.

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Recovery of VAT on transaction costs: New case law developments

Group reorganisations, mergers and acquisitions generally require third party professional and other services to be procured. From a VAT perspective, the VAT deductibility of these costs, which are typically borne by a holding company in the acquisition or disposal of shares, has been the subject of a long standing debate both at UK and EU levels. A recent decision of the Court of Justice of the European Union ("CJEU") may however, finally bring some certainty to this issue.

The basic functions of holding companies are to acquire and hold shares in subsidiaries from which they may receive dividends; defend themselves and their subsidiaries from takeovers, and make disposals. Where a holding company solely performs these functions, it has long been established by the CJEU that they are not considered carrying out an economic activity for VAT purposes. Consequently they do not have a right to deduct any VAT they incur on their costs.

These holding companies are referred to as "passive holdings".

However, where holding companies also involve themselves in the management of their subsidiaries by supplying them administrative, financial, commercial or technical services for consideration, they are considered carrying out an economic activity for VAT purposes (CJEU decisions *"Polysar" (C-60/90), "Cibo" (16/00)*). Thus to the extent the services supplied carry a right to deduct, they are entitled to recover, at least partially, the VAT they incur. These holdings are referred to as "active holdings".

It is the manner in which such active holdings determine their VAT recovery right (and therefore the level of VAT recoverable) that has been the subject of much debate in the UK as although the CJEU had already arguably taken clear position on the matter, HMRC had in recent years taken a different, stricter approach, following a case in the UK Court of Appeal.

In the joined cases *Larentia + Minerva (C-108/14)* and *Marenave Schiffahrt (C-109/14)*, the CJEU has reaffirmed and further clarified its previous case-law, and has shed new light on the specific of VAT grouped holding companies. As a result it is hoped that in the UK HMRC will now bring its policy into line with the Court of Justices' decisions which should generally produce a more a more favourable deduction regime for UK holding companies.

HMRC's historic position and differences with the decisions of the Court of Justice of the European Union

Recovery of VAT incurred on costs is determined in the first instance, to the extent that costs are directly and immediately attributable to specific outputs, the VAT thereon is fully recoverable where the output carries the right to deduct. Any VAT which cannot be directly attributed will generally be accepted as a general overhead of the taxable person (commonly referred to in the UK as "residual

input tax"). This VAT is recoverable by reference to the activity of the business as a whole.

The CJEU has constantly held that deal costs fall into the overhead category (CJEU decisions *"Securenta" (C-437/06), "Cibo Participations" (C-16/00), "Portugal Telecom" (496/11)*).

In 2013, the UK Court of Appeal released its decision in *BAA* (*British Airport Authority decision (BAA) versus England and Wales Court of Appeal Civ 112 [2013]*) which related to a holding company's entitlement to recover VAT on costs associated with the acquisition of a target company.

Once the target had been acquired, the holding company joined the VAT group. The VAT group then claimed recovery of the VAT incurred on the deal costs on the basis of the VAT group's recovery right.

The Court of Appeal first found that at the point the holding company was established to purchase BAA, and incurred VAT, it was not considered carrying out an economic activity for VAT purposes as it had no intention other than to passively hold the shares. As the simple acquisition and holding of shares falls outside the scope of VAT, BAA had no entitlement to recovery. The Court of Appeal further stated that this position was not altered by the fact that the holding company subsequently joined the BAA VAT group.

There was, in the Court's view, an insufficient link between the deal costs and taxable outputs of the BAA VAT group to allow recovery.

Given the fact pattern, this decision was not expected to have wider application where the holding company was able to evidence its intention to provide taxable services post-completion and did so (whether or not it is ultimately VAT grouped). Where it could evidence this intention, it was expected that the holding company did undertake an 'economic activity' which should support VAT recovery. It has been standard industry practice for a number of years for a holding company to actively manage its investments and to fully evidence this at completion.

However, HMRC issued a brief in September 2014 and amended its guidance outlining its revised policy following the Court of Appeal decision in BAA. In that amended guidance HMRC states that VAT incurred by a holding company on deal costs is only recoverable where the deal costs can be directly and immediately linked to taxable supplies, therefore disregarding the position of the CJEU in its most key decisions on holding companies.

HMRC's guidance also downplayed the previously understood right of an active holding company in a taxable VAT group to recover overhead VAT.

Within the revised guidance, HMRC asserted that:

- VAT incurred by a holding company is only recoverable by a holding company (whether in a VAT group or not) where there is a direct and immediate link to the performance of taxable supplies;
- A direct and immediate link requires the input VAT to be used, or intended to be used, in the making of taxable supplies. The "costs incurred must be components of the price of the taxable supplies" such "that the expenditure will be recouped from the income resulting from these supplies";
- It can be sufficient for costs to be recovered/recouped "over a period of time". In the case of acquisition deal fees HMRC have accepted that there is a safe-harbour for VAT recovery where the VATable costs are recouped over a period of 5 to 10 years;
- It is not sufficient for a holding company to make a charge to subsidiaries. The fee the holding company receives must be for goods or services it provides. To satisfy this requirement the holding company needs sufficient substance to provide such services;
- VAT incurred on deal costs does not become recoverable merely as a result of the holding company joining a VAT group. Where the holding company is part of a VAT group, the VAT it incurs on deal costs may be recoverable only if it is engaged in economic activity and making supplies to subsidiaries within the VAT group, where the subsidiaries are making onward taxable supplies.

Larentia + Minerva (C-108/14) and *Marenave Schiffahrt (C-109/14)*

The Court of Justice has now released its much anticipated decision in relation to the joined cases of *Larentia + Minerva* and *Marenave Schiffahrt* referred to it by Bundesfinanzhof in Germany.

The court upheld the Advocate General's Opinion ('AGO') in this case that holding companies involved in the management of their subsidiaries for consideration, have a right to claim the VAT incurred on the costs of raising capital to finance share purchases.

The Court reaffirmed its position that VAT incurred on acquisition costs qualifies as residual input tax (so called in the UK) and is therefore deductible by reference with the activity of the holding company as a whole (i.e. there is no need to have a direct and immediate link with specific supplies).

The Court makes a clear distinction between the situation where apportionment of the input VAT incurred by a holding company on acquisition costs must be made between economic activity and non-economic activity, and those where it must not.

In fact, it is only where a holding company involves itself in the management of only some of its subsidiaries, thereby carrying out a non-economic activity with respect to those it does not manage, that costs incurred on the acquisition of its subsidiaries must be regarded as only partially belonging to economic activity and therefore an apportionment is required between the holding company's economic activity and its non-economic activity.

Where a holding company routinely provides services to all of its subsidiaries for consideration, it's clear from the Court's judgement that the VAT it incurs on costs relating to the acquisition of those subsidiaries has a direct and immediate link with its economic activity as a whole and is recoverable. Furthermore, that recovery is by reference to its economic activity as a whole. There is no requirement for this VAT to also be viewed as relating in any way to the non-economic activity of holding the shares in the subsidiaries held.

Although in this case the position of a holding company in a VAT group was not specifically addressed, consistent with the opinion of the Advocate General the Court appears to accept that if a VAT group existed, recovery of VAT incurred on deal fees would be based on the position of the VAT group as a whole. Thus, if the VAT group was fully taxable, the VAT on the deal fees would be recoverable in full.

It is noticeable that this reflects the approach of the Court of Justice in *Skandia* that a VAT group is a taxable person separate from its members which has its own status from a VAT perspective.

Impact of the decision

Current HMRC policy requires the holding company to charge for management services and recoup the costs of acquisition over a 5 to 10 year period to recover the VAT. Where the company is grouped with the subsidiary, these charges must still be made, and the group must then use the intra group services to make taxable supplies to external third parties.

This Judgment creates an opportunity for holding companies providing taxable services to their subsidiaries to consider situations where VAT incurred on expenditure is related to the acquisition of subsidiaries and was previously restricted, as it may now be recoverable.

HMRC had recognised that *Larentia and Minerva* might require their current policy to be changed. The interesting questions now are (i) the extent to which they will accept the need to change their guidance and (ii) whether they will maintain that a holding company in a VAT group, were the VAT group makes taxable supplies, still has to make the disregarded intra group management charges to secure VAT recovery. On this latter point, how they ultimately decide to interpret the *Skandia* decision may have some bearing.

If the subsidiary acquired does not join the VAT group, and the acquiring holding company holds it passively, then the VAT incurred on acquisition costs by the VAT group is likely to remain irrecoverable since in that situation the VAT will be used for a non-economic activity. The CJEU decision recognises that if all the subsidiaries are not managed and they are separate taxable persons from the holding company, some VAT apportionment will be required to reflect the non-economic activity.

Until HMRC publishes revised guidance on the issue, it is advisable to continue relying on their existing guidance, i.e. have the parties join a VAT group that carries out taxable supplies and have the holding company make the disregarded intra VAT group management services in order ensure VAT recovery is secured.

Where historically VAT recovery has been restricted and following *Larentia and Minerva* it may be recoverable, then subject to the time limits for making a claim clients may want to consider making a claim to recover that tax.

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New HMRC practice on corporate reorganisations: Stamp duty relief

More private companies are considering initial public offerings ("IPOs"), either as a method of raising finance and a way to incentivise management or as an exit strategy.

Prior to any IPO, corporate groups often restructure and it is common for a new top company to be inserted, the shares in which are to be admitted to trading. This is often done by way of a share-for-share exchange, whereby the new top company ("Newco") acquires the entire issued share capital of the existing top company ("Target Co") in exchange for newly issued shares. Where Target Co is UK-incorporated, stamp duty applies on the acquisition of its shares by Newco.

Many of you will be familiar with 'share-for-share exchange relief' from stamp duty (relief under section 77 FA 1986). The relief has a number of stringent conditions, including the requirement that the shareholdings in the acquiring company (Newco) after the transaction mirror those in Target Co immediately before it, in terms of shareholders, share classes and proportions of shares held.

The legislation, read closely, defines "shares" by reference to "stock". The meaning of "stock" is taken from an Act passed in 1891 and includes any share in the "funded debt" of a company. "Funded debt" is not defined and could include any loans issued by a company for the purpose of raising capital that have some "degree of permanence or long-term character" (see Reed International v IRC [1976] A.C. 336). Consequently, read literally, section 77 requires any debt that has the character of funded debt that has been issued by Target Co to be acquired and reissued by Newco. Historically, HMRC did not take this point, at least where an assignment of the debt would be exempt from duty under the loan capital exemption. However, that practice has changed.

Last month HMRC circulated draft guidance on what they consider 'funded debt' to be. HMRC are likely to confirm that debt instruments issued by Target Co such as bonds or loan notes which represent long-term capital financing and which can be traded separately are funded debt, whereas mortgages, bank loans and overdrafts are not.

This position is arguable. One could argue that Parliament couldn't possibly have intended for "stock" in this context to include anything other than shares. The language used to explain the conditions for the relief refers to issued share capital and classes of shares. The use of the word "classes" is not apt to define debt. Further, the relief requires that immediately after the acquisition, the number of shares of any particular class in Newco bears to all the shares in that company the same proportion as the number of shares of that class in Target Co as immediately before the acquisition. While meeting this condition is relatively straightforward when dealing solely with shares, the position is more complicated where both shares and debt are held. The meaning of "stock" in the 1891 Act is qualified by the preceding words "unless the context otherwise requires".

One could argue that in the context of a reorganisation that would meet the conditions for relief in section 77 but for the meaning of stock including funded debt does require stock to mean only issued shares.

However, HMRC appear to be committed to their view. Any claim for relief which does not take into account any issued funded debt will be denied. We therefore recommend that a thorough review of any debt owed by Target Co is carried out before any share-for-share transaction to assess whether the debt could reasonably be viewed as issued funded debt in line with HMRC's position. Unless HMRC revert to their past practice or they are overruled by the courts, any issued funded debt must be discharged or assigned/novated before the transfer, or it must be acquired and re-issued by Newco after the transfer to avoid any argument on the availability of the relief.

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Restriction of relief for amortisation on the acquisition of goodwill and "customer related intangibles"

The Budget included provisions, which came into effect on 8 July 2015, to prevent a purchaser in a trade and asset deal from obtaining amortisation or impairment relief on goodwill and certain defined "customer related intangibles". The Explanatory Note states that this will remove the "artificial incentive to buy assets rather than shares"; it could equally be argued that the substantial shareholdings exemption and entrepreneur's relief are artificial incentives to sell shares rather than assets. This change does not appear to have been trailed at all, and it is surprising that HMRC regard this as a "fairness" issue.

Where a corporate purchaser buys shares, the company will not be treated as acquiring goodwill for tax purposes (although goodwill may be recognised in the consolidated accounts). Where the corporate purchaser bought trade and assets before 8 July 2015, then provided that the vendor was not a related party, the company was treated as acquiring goodwill on which it could claim relief for amortisation and impairment. The claim could either follow the accounts or an election could be made for relief on a straight line 4% basis. This relief has now been removed.

The assets on which relief can no longer be claimed include:

(a) Goodwill;

(b) An intangible fixed asset that consists of information which relates to customers or potential customers of a business;

(c) An intangible fixed asset that consists of a relationship (whether contractual or not) between a person carrying on a business and one or more customers of that business;

(d) An unregistered trade mark or other sign used in the course of a business; or

(e) A license or other right in respect of an asset within any of paragraphs (a) to (d).

These assets are generally those which could fall within an accounts category of goodwill. The HMRC Capital Gains Manual says that they regard an unregistered trade mark as an intrinsic part of goodwill. Thus, the scope of the legislation is effectively a very broad definition of goodwill.

Where an asset which is within the intangibles regime in Part 8 CTA 2009 is transferred between two UK companies which are members of the same group, the transferee is treated as standing in the shoes of the transferor, so an intra-group transfer on or after 8th July 2015 would not be expected to bring this new rule into effect.

There is a further change to restrict the utilisation of a loss on the disposal ("realisation") of goodwill and customer related intangibles where a business is sold by a trade and asset deal. A debit on disposal will be treated as a non-trading debit, which means in particular that it cannot be offset against a trading profit in a different year. Any profit on disposal will continue to be treated as a trading credit.

The new legislation should not apply to registered trade marks, registered patents, software protected by copyright (although potentially not where there is an asset which combines software and customer data). There may be tax benefits, as well as legal benefits, in registering trade marks, logos, design rights etc.

As the use of the internet in business increases, it is increasingly like that there will be assets where it is difficult to tell whether they fall within this legislative wording or not. For example, domain names incorporating unregistered trade marks, the use of "cookies", social media followers etc. It is to be hoped that HMRC will be able to issue clear guidance on this.

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