A NEW ECONOMY **PUBLICATION**

BUSINESS IN THE UK
A ROUTE MAP

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BDO

chapter 04

ACQUIRING AN EXISTING COMPANY

ACQUIRING AN EXISTING COMPANY

Buying an existing company may be a quick way to acquire a profitable UK business with an established customer base, goodwill and supplier relationships but the costs and risks can be nearly as high as starting a new business.

Under UK law, the historic liabilities of the business stay with it no matter who the new shareholders are. So, in many cases, simply acquiring the particular trade and assets that the business really wants, rather than the whole company, is the best option. However, for tax reasons, the vendors will often prefer a share sale.

When a UK company is acquired, it is not necessary to re-register the company with UK Companies House or HMRC – registrations completed when the company was originally set up continue. However, that does not prevent the new parent company amending the company's existing articles of association to ensure they meet its needs, for example, by removing any restrictions on the issue of new shares.

The ongoing legal, accounting and tax requirements of an acquired company will be exactly the same as those for a company which has been set up from scratch. Read about BDO's mergers and acquisitions services.

THE UK MARKET

The UK has one of the most mature mergers and acquisitions markets in the world, with experienced advisers, a clear legal system, exceptional talent, access to funding, and well established custom and practice.

The UK also benefits from having Europe on its doorstep, close relations with the US, and the Commonwealth opening up many of the fastest growing economies on the planet. Combine this with a culture of entrepreneurial and innovative thinking, and UK companies are naturally a target for international investors.

KEY STEPS

Once a non-UK business has a clear idea of what sort of UK business is to be bought, there are numerous advisers (including professional services firms and investment banks) who can help a potential buyer to map the market and help identify potential investments.

Having identified a target, those advisers can then facilitate an introduction whilst maintaining confidentiality for the potential buyer, and provide support around the valuation and transaction structuring.

WHAT – are 'heads of terms'?

'Heads of terms' (also known as 'letters of intent' and 'memoranda of understanding'), is an initial document which sets out the key parameters of the deal (eg valuation, timetable, due diligence requirements and the key conditions). Usually, these heads of terms are not legally binding but clauses setting out an exclusivity period and confidentiality clauses should be legally enforceable.

The identification of the target and negotiation of the heads of terms will usually be based on limited information, provided by the target through its advisers. A formal 'due diligence' process allows the buyer's advisors to find out more about the business and subject the information available to independent scrutiny to give the buyer a clear understanding of the target's viability and value.

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DUE DILIGENCE

Due diligence is not a legal requirement so there are no UK laws setting out the process. In the UK, it is common for vendors to commission independent vendor due diligence for potential investors. It is equally common for potential investors to engage an adviser to comment on and 'top up' this work and suggest what legal protection should be sought through warranties and indemnities to be incorporated in the acquisition agreement. Read more on this process on page 39.

Read about BDO's mergers and acquisitions services.

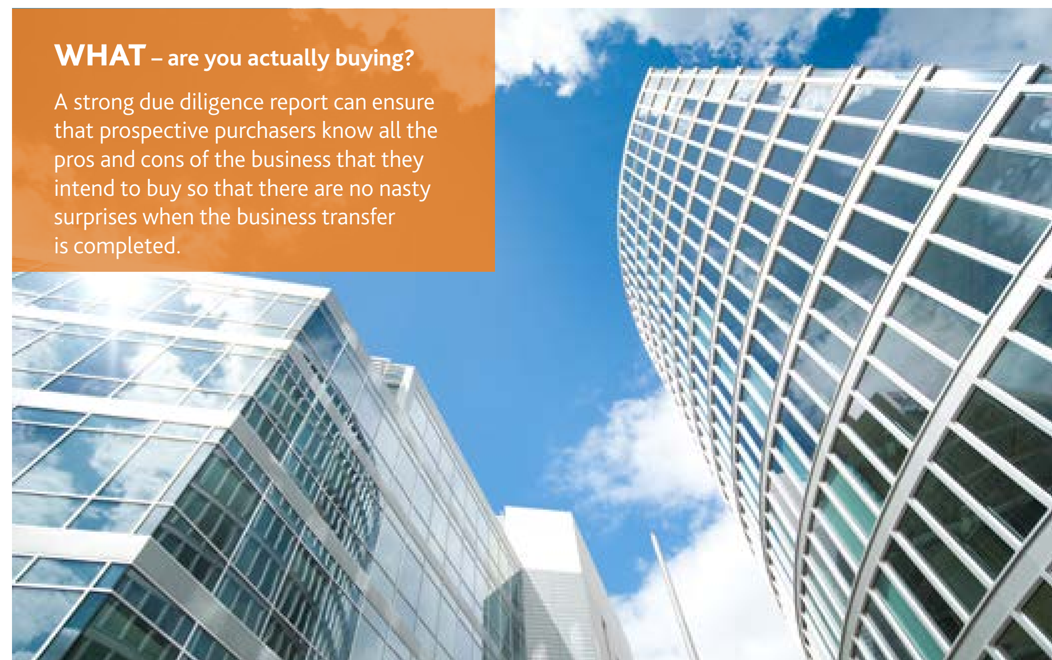
WIDER CONSIDERATIONS

The consideration of a suitable acquisition candidate clearly involves a wider range of issues than are detailed in this section. The compatibility of systems and processes, corporate culture and management style, to name a few.

KEY INBOUND TAX CONSIDERATIONS

There are a number of tax implications which may influence how non-UK investors structure the acquisition of an existing UK operating company. The table that follows addresses the tax position of the purchasing company. However, some consideration of the vendor's tax position is necessary: the more a purchaser understands the vendor's position and motivations the easier it is to negotiate acquisition terms that are acceptable to all parties.

The table on this page provides a high level overview of the main tax consideration we cover in this chapter. This should not be considered an exhaustive list and other tax consequences may be encountered in practice.



WHAT – **are you actually buying?**

A strong due diligence report can ensure that prospective purchasers know all the pros and cons of the business that they intend to buy so that there are no nasty surprises when the business transfer is completed.

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TAX CONSIDERATIONS	ASSET PURCHASE	SHARE PURCHASE
Purchaser	• Stamp Duty Land Tax (Land and Buildings Transaction Tax in Scotland) payable within 30 days on land/property involved • VAT may apply to the purchase price (can be exempt subject to certain conditions) • Increase in tax base cost of assets acquired • Capital allowances available on property (subject to joint election), but the tax losses of the target are left behind • The acquiring company must register for UK taxes with HMRC (corporation tax, VAT, and payroll taxes), but tax history of target remains with the vendor.	• Stamp Duty payable within 30 days on land / property involved • No VAT applicable (but recovery of VAT on advisors' fees relating to the deal if more complex) • No increase in the tax base cost of the underlying assets • Acquire the tax attributes of the company (tax losses and capital allowances) subject to anti-avoidance provisions • Inherit the tax history of the company (with protection afforded via tax warranties and indemnities).
	• What type of entity to use for the acquisition • How to finance the acquisition (debt or equity) • Future exit strategies.	
Vendor	• Taxable disposal subject to corporation tax less any base cost of the assets sold • Generally no base cost for internally generated intangibles (eg goodwill) leading to potentially significant taxable profits for the vendor • Consideration would then need to be given to the personal tax implications of the ultimate shareholder in terms of extracting the cash from the company.	• If the vendor is an individual, subject to capital gains tax but could qualify for lower tax rate if entrepreneurs relief applies • If the vendor is a company, the disposal may be tax-free under the substantial shareholding exemption.

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WHAT TO BUY: ASSET PURCHASE VS. SHARE PURCHASE

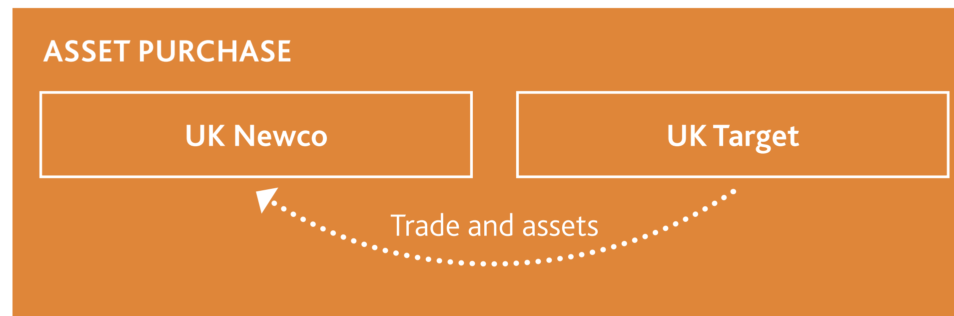
Generally, it is more common in practice to see acquisitions structured as a share purchase than as a trade and assets sale.

Although there may be other commercial and practical considerations, from a tax perspective the primary reason for this is the availability for the vendor of a tax-efficient exit (see further comments in Chapter 5).

ASSET PURCHASE

Suppose, as illustrated below, that a new UK limited company ('UK Newco') is to be incorporated to facilitate a trade and asset purchase from the vendor company ('UK Target'). There are also other UK business entities (such as Limited Partnerships or LLPs) which could be utilised to facilitate such an acquisition.

The UK Newco will have an obligation to register with HMRC for corporation tax, VAT (sales tax) and payroll taxes. The following taxes will be relevant in a trade and asset purchase from UK Target.



VAT

No VAT applies to the transaction where the purchase qualifies as a Transfer of a Going Concern (TOGC) for VAT purposes. To qualify as a TOGC there are many detailed conditions to be met and prospective purchasers should take expert advice well in advance of any transaction.

If the purchase will not meet the conditions to qualify under the TOGC rules then VAT at 20% would be added to the price. Depending on the trade undertaken by UK Newco, it may be possible to recover the VAT – although this may not be recovered for a period of months and may have a negative impact on the cash flow of UK Newco.

Read about BDO's VAT services.

STAMP DUTY LAND TAX (SDLT)

As discussed in Chapter 6, purchasers must pay SDLT (or Land and Buildings Transaction Tax in Scotland or Land Transaction Tax in Wales) if they buy property or land over a certain price in the UK (note that SDLT rates may be substantially higher if acquired property contains 'residential' elements). SDLT also applies to purchases of certain rights over land, for example, if UK Target has any leasehold interests. Any SDLT must be paid by the purchaser within 30 days of the transaction date on the total consideration (ie the price paid for the property or land, and any assets, fixtures, goodwill, fittings and any VAT paid). An SDLT return must be filed within 14 days of completing the land transaction.

Where the sale price includes payment for other assets (such as moveable machinery) these assets must be valued at a rate reflecting their fair market value and deducted from the consideration for SDLT purposes. Such an allocation of the purchase price should be included in the asset purchase agreement. It is important to give thought (and to seek necessary advice) in the early stages of any purchase as to how the consideration will be split and the tax implications, and to enlist the help of a valuations expert.

Read about BDO's real estate tax services.

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CORPORATION TAX – CAPITAL ALLOWANCES ON A PROPERTY PURCHASE

When a property is acquired, if the vendor has been claiming capital allowances in respect of plant and machinery within the building, an attribution of the sale proceeds will need to be made in respect of assets which qualify for capital allowances.

This figure will need to be brought into the vendor's capital allowance computations included within their final tax return. Similarly, UK Newco will need a figure on which to claim allowances in future.

The parties must, under UK tax legislation, enter into a formal election to fix the values of the assets for capital allowance purposes (or apply to the Tax Tribunal for a value to be determined). How this is structured can have immediate tax implications for the vendor and ongoing implications for the purchaser so expert advice is needed in this area.

A buyer of a 'second-hand' building can also only obtain capital allowances if the vendor has 'pooled' its capital expenditure – this is another issue that purchasers will need to investigate at an early stage in the due diligence process to avoid potential loss of valuable allowances.

Read about BDO's capital allowances services.

CORPORATION TAX – TREATMENT OF PURCHASED GOODWILL

A general benefit of an asset purchase is that, for tax purposes, it increase the base costs (recorded value) of the assets to the price paid. However, there is no corporation tax relief for companies that write off the cost of purchased goodwill and certain customer related intangible assets, on the acquisition of a business. Any taxable profit or tax loss would crystallise when such an asset was subsequently sold.

Read about BDO's mergers and acquisition services.

WHAT – tax liabilities will arise if the transaction is structured as an asset purchase?

There can be both VAT and SDLT liabilities to be paid if a purchaser opts to buy the trade and assets of a business rather than buying the whole company. However, the risks of acquiring the company's other obligations associated with the individual assets can also be high so careful research will usually be needed.

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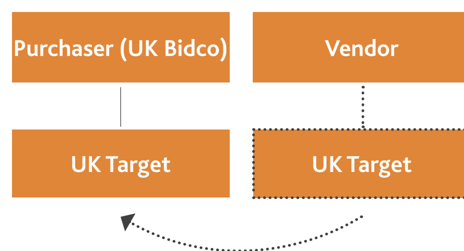
SHARE PURCHASE

If shares in the UK Target company are acquired, all its assets, past liabilities and obligations are acquired. To avoid taking on hidden liabilities (eg claims from customers triggered by failure of goods bought years ago or claims arising for incorrect advice given in the past), purchasers usually prefer to undertake an asset purchase (and acquire only the specific assets and liabilities agreed). However, from a vendor's perspective, a share sale is normally preferred as this often enables a tax-efficient exit and achieves a clean break with the business sold.

Suppose a new UK Limited company ('UK Bidco') will be incorporated to facilitate the purchase of the shares in UK Target, as illustrated below:



As the tax history of UK Target will be acquired along with the shares of the company, it is normally recommended that a comprehensive due diligence exercise is undertaken.

There is no 'standard' tax due diligence exercise. Each acquisition will have a different risk pattern, and will also be dependent on the nature of the underlying business, the market in which it operates, and the attitudes of the vendor and purchaser to risk. The due diligence exercise will normally include a review of the main UK taxes for a period of up to four years (four years represents the default time period that HMRC can make a 'discovery assessment' on historic tax liabilities). Note though that these time limits are amended to six years and 20 years for cases involving careless and deliberate action respectively by the taxpayer).

There are key benefits of a tax due diligence when undertaking a share purchase. It should:

- Reveal any historical or future tax exposures or any unfunded tax liabilities which could impact price negotiations (ie whether or not filings and payments are complete and up-to-date)
- Provide a clear picture of the tax affairs of UK Target including quantifying any 'tax assets' being acquired (ie losses or capital allowance pools)
- Identify any potential tax charges that may be triggered by a change in ownership (ie degrouping charges) so that such issues can be factored into the proposed transaction structure.

TAX INDEMNITIES AND WARRANTIES

Typically, a buyer will seek protection against any potential tax liabilities inherited from the vendor. A tax due diligence exercise will help decide the scope of tax indemnities and warranties to be included in the Share Purchase Agreement (SPA). The warranties and indemnities, and any limitations on their application, will be an important – and potentially substantial – part of the negotiation process. It is critical to seek the necessary legal and tax advice in this process.

TAXES TRIGGERED ON A SHARE PURCHASE

The acquisition of the shares in UK Target will give rise to stamp duty of 0.5% payable in respect of the consideration for the shares. The stamp duty and supporting documents must be provided to HMRC within 30 days of the acquisition.

If UK Target owns property with 'residential' elements, then an Annual Tax on Enveloped Dwellings ('ATED') return and potential charge (dependent on property value) may apply – reliefs are available in certain instances though.

Unlike an asset purchase, there is no VAT applicable on a share purchase. No tax relief will be available for the underlying or consolidated goodwill bought. Other key tax considerations in a share purchase acquisition include:

- The recovery by the purchaser of any input VAT paid on the fees charged by its advisors (ie lawyers, tax advisors etc) – specific guidance should be sought at the earliest stages of planning an acquisition
- Under UK tax rules, trading losses can be carried forward indefinitely and offset against future trading profits but there are conditions to be met and specific anti-avoidance provisions (in order to target 'loss buying' situations).
- From 1 April 2017, UK corporate loss rules have been made more flexible in that all tax losses arising after 1 April 2017 (except capital losses) will be available to offset against any other type of income in any UK 'Group' company. In addition, under these changes groups will (broadly) only be able to shelter 50% of their tax adjusted profits over £5m with brought forward losses. Note that there are also further anti-avoidance provisions introduced to counter 'corporate loss buying'.

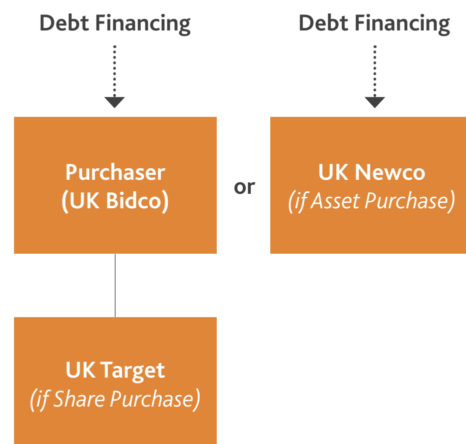
Read about BDO's mergers and acquisition services.

ACQUIRING AN EXISTING COMPANY

HOW TO FINANCE THE ACQUISITION

Purchasers may choose to finance the acquisition with debt (borrowing) or equity (share capital): the key tax considerations for each route are outlined below but please also see Chapter 5 Business Finance.

FINANCING AN ACQUISITION WITH DEBT



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UK WITHHOLDING TAX ON INTEREST PAYMENTS

In most circumstances, UK law requires income tax (normally referred to as withholding tax) to be deducted from interest payments. 20% of the interest payment will need to be paid to HMRC each quarter when the interest is paid. However, in some circumstances no UK withholding tax will be due, including:

- Where the recipient is a UK company (or a company in a country with which the UK has a relevant double tax treaty – see comments below)
- Payments of interest on a quoted Eurobond
- Payments of interest paid to or by a UK bank (or a UK branch of a foreign bank)
- Payments of 'short' interest – essentially interest on loans that will not be outstanding for more than a year. However, this definition can be contentious, and detailed advice should be taken if intending to use this exemption.

If the recipient is an individual, UK withholding tax will apply. Where the recipient is a non-UK entity, withholding tax will need to be deducted at 20% and paid to HMRC, unless treaty clearance has been obtained to apply a lower rate of withholding tax before the interest is paid.

Read about BDO's Corporate International Tax Services.

UK CORPORATION TAX DEDUCTIONS FOR INTEREST PAYABLE

Interest payable by a UK company will generally be deductible from its profits for tax purposes on an accruals basis, unless:

- The paying company is 'close' and the individual/corporate recipient is a participator in that company, or
- The loan is made to the company by trustees of an occupational pension scheme.

In these circumstances, the interest charge will only be deductible if it is actually paid (either in cash or in kind).

Any loan interest payable will also be subject to transfer pricing, thin capitalisation and other UK anti-avoidance provisions when calculating the UK corporation tax deduction. From April 2017, the UK replaced its worldwide debt cap provisions and now imposes a new cap on interest deductions following the OECD guidelines in BEPS Action 4. Broadly, this restricts interest deductions to 30% of the EBITDA where interest paid exceeds a de minimis level of £2m per year.

Additionally, rules were introduced from 1 January 2017 which potentially deny deductions in a UK company for interest where there has been a 'hybrid' mismatch. The rules seek to address mismatches whereby:

- Double deductions are claimed for the same expense, or
- Deductions are claimed for an expense without the corresponding receipt being fully taxed.

Read about BDO's transfer pricing services.

FINANCING AN ACQUISITION WITH EQUITY

The UK does not impose withholding tax on the payment of dividends by a UK resident company irrespective of the recipient of the dividend. No corporation tax deduction is available to the paying company making distributions by way of dividends to its investors.

HOW – is the purchase going to be financed?

If the purchaser is not buying the business wholly with cash, assessing whether it is better to fund the purchase with borrowing or through a share issue is vital because it can have a significant impact on short- term costs and the overall return from the investment.

ACQUIRING AN EXISTING COMPANY

USING A UK COMPANY (IE UK BIDCO) AS A HOLDING COMPANY

For share purchases, buyers should carefully consider in which jurisdiction the holding company for the acquisition should be incorporated. In recent years, the UK has become a more attractive location for holding companies for a number of tax reasons:

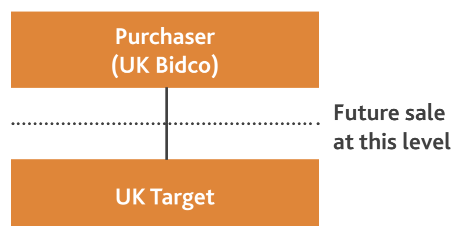
- It has one of the lowest corporation tax rates in the G20
- Dividends received by a UK holding company from other UK companies or from overseas companies will (in most cases) be exempt from UK corporation tax
- The UK has an extensive network of international double tax treaties which allow for access to potentially favourable withholding tax rates
- Numerous corporation tax reliefs are available, such as the UK Research and Development (R&D), Patent Box regime, and Annual Investment Allowance for capital expenditure
- Other UK tax reliefs for individual investors and management
- Certain tax-efficient exit strategies are available (see below).

Read about BDO's corporation tax services.

The UK is also often considered an attractive base by investors due to its established and well regarded legal and regulatory structure and operating environment (see Chapter 1).

EXIT STRATEGIES

The UK tax regime allows for a tax-free disposal on the sale of the shares of a company by a UK holding company under the substantial shareholding exemption (SSE). For example, in the share purchase scenario above, UK Bidco could potentially make a future tax-free disposal of UK Target:



In broad terms, for the SSE to apply, UK Bidco must own at least a 10% stake in UK Target for a period of 12 consecutive months in any of the six years prior to the date of disposal. The 10% stake must consist of:

1. 10% of the 'ordinary share capital' of UK Target (by nominal value), and
2. A beneficial entitlement to 10% of the profits available for distribution, and
3. A beneficial entitlement on a winding up to 10% of the assets available for distribution.

The UK Target company must be a trading company (or the holding company of a trading group) for 12 consecutive months before the disposal. This relief makes it attractive for non-UK businesses to invest in UK businesses.

If the owner is a UK resident individual (as opposed to a corporate entity), various reliefs such as entrepreneur's relief (ER) may be available to reduce the marginal tax rate.

However, there are qualifying conditions so it is important to plan carefully. The UK does not impose withholding tax on non-UK residents selling shares in a UK company (subject to very limited exceptions in the case of companies owning residential property).

FURTHER TAX CONSIDERATIONS

Relocating or utilising employees from overseas to assist in the UK activities may give rise to UK payroll obligations (including pension auto enrolment (see Chapter 7).

International trading from the UK can give rise to EC VAT registrations, Customs Duty and distance selling requirements (see Chapter 8).

There are also regulatory issues and financial reporting requirements to consider.

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