

Private Equity Club 2009

Facing today, tomorrow and the day after*



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Tax – the latest thinking on structuring, VAT and other developments

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Tax – the latest thinking on structuring, VAT and other developments

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VAT update

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VAT Update from 15 July 2009 Private Equity Club

Transactions

- VAT recovery on deal / transaction costs: *MyTravel*, *AB SKF* and *BAA*
- EU Commission's proposal on VAT Grouping

What should you be doing?

- Review structures used – are they still 'fit for purpose'?
 - Assemble / retain all relevant paperwork: is it all in order?
 - Supporting evidence / 'gaps'?
- Take care in responding to HMRC
 - Take the initiative: robust approach
- Protect your position
 - Alternative claims?
- Consider impact on current / future deal structuring and adviser engagements

VAT Update

Firms / Funds

- Liability of supplies
- Offshore funds
- Partial exemption

Fund structure
Does it matter to the portfolio company?

Brian Leyland

Partner, PricewaterhouseCoopers LLP

Background

- Tax services to private equity can be broken down as follows
 - advice and compliance services to the fund
 - work on the deal structure
 - advice and compliance to the portfolio company
- Most advisers use different teams to provide this advice

Has anything changed?

- Government put tax to the top of the PE agenda (Schedule 22, transfer pricing etc)
- Increasing awareness of the value which tax can add
- Focus on squeezing value from portfolio in last 12 months

What examples are there? (1)

Interest paid by portfolio companies - timing

- deductible on accruals or paid basis?
- is the company affected by the new rules?
- if yes, does it make sense to elect out of the rules?
- does the issue of PIK notes in respect of the interest affect the tax liability of the investors / fund executives?

What examples are there? (2)

Interest paid by portfolio companies - transfer pricing

- if the interest is disallowed, will the investors / management / vendors benefit from a compensating adjustment?
- if yes, does security on the debt prevent a claim being made?
- how best to manage the compensating adjustment process?

What examples are there?(3)

Interest paid by portfolio companies - withholding

- Have the funds all been advanced by a partnership?
- Have some of the funds been lent directly?

What examples are there? (4)

Is the company under the control of another company?

- Does the PE house have a majority interest?
- Is the GP a company?
- If the GP is a partnership, is there a corporate partner /member?
- Implications
 - PAYE obligations for shares issued at undervalue
 - no tax deduction for share option exercises
 - no possibility of introducing tax approved option scheme

What examples are there?(5)

Is the company a member of a group?

- Is there as common holding company for all portfolio companies?
- Implications
 - group relief
 - debt cap
 - Senior Accounting Officer obligations

Points to consider

- Does your deal structuring paper address the target issues only or does it make reference to the implications for the fund?
- Do you get questions from the portfolio company and/or their advisers?
- Are you getting a joined up service?
- Are you losing value as a consequence of unnecessary tax leakage?

Some current deal structures

Vendor rollover into ordinary shares

- Historically vendors received cash, loan notes and sweet equity in Newco
- Recently, more common to see vendors receiving cash and ordinary shares
- PE house subscribes for shares at a price lower than implied value

Consequences

- Ordinary shares in the money from day one
- Is it intended to give incoming managers ordinary shares?
- Will they pay market value? If not, who should bear the tax risk?
- Possible solutions
 - EMI scheme where possible
 - Growth shares?

All equity deals

- Can be attractive in current climate for a number of reasons e.g. where speedy completion required
- Tax implications
 - no benchmark for MOU purposes so no safe harbour for management shares
 - deductibility of interest? Would bank debt have been available?
- Consider splitting the shareholder loan between a "senior facility" and a traditional institutional loan

Using LLPs

- Contribute business to an LLP in which managers are the members
- PE house invests via Newco as before
- Good leaver / bad leaver / drag / tag incorporated in LLP agreement
- Managers income rights equivalent to "salary", capital rights linked to formula, depending on level of acquisition debt

Using LLPs (2)

- Advantages
 - Profit enhancement - saves NIC
 - availability of entrepreneur's relief
 - more flexibility regarding changes to management interests
 - possible tax deduction for purchaser for intangibles
- Disadvantages
 - additional level of complexity
 - less well understood by purchasers

Using LLPs (3)

- Most suitable for quasi partnership / people businesses
- More difficult for captives
- Can be useful for reincentivising management

Bank payroll tax and offshore funds

Tim McCann

Director, PricewaterhouseCoopers LLP

Bank payroll tax

Applies to:

- A taxable company (e.g. a bank, or a member of a banking group) subject to certain exclusions
- Chargeable on the relevant remuneration (>£25,000)
- On relevant banking employees
- Engaged wholly or mainly in relevant regulated activities

Charged at a rate of 50%

Charge is not tax deductible

Bank payroll tax – application to private equity

- Only applies to BIPRU 730k investment firms
- Excluded companies (e.g. operators of collective investment schemes)
- Does not apply to members of LLPs
- Only applies to employees engaged wholly or mainly in relevant activities
- Distributions of carry are capital and not earnings

The offshore funds regime

•Background

- Purpose of original regime
- Implications on marginal tax rates (gains taxed as income)
- Distributing fund status
- Limited application to private equity because of narrow definition

•Recent developments

- New broader definition with effect from 1 December 2009 (with grandfathering for existing structures)
- Reporting fund status replaces distributing fund status from 1 December 2009
- Application to private equity structures....?

Old definition of offshore fund

- A collective investment scheme, resident outside the UK, constituted as a company, unit trust or other arrangements, that create rights in the nature of co-ownership
- Collective investment scheme has the meaning given by Section 235 of the Financial Services and Markets Act 2000
- Material interest: broadly speaking, able to realise investment at net asset value within seven years, whether by transfer, surrender or some other manner.

New definition of offshore fund

- Statutory definition de-coupled from FSMA 2000.
- Offshore fund means... a 'Mutual fund' – body corporate, trust or other arrangements that create rights in the nature of co-ownership (but not persons carrying on a business in partnership)
- Mutual fund – arrangements with respect to property of any description, including money, that satisfy conditions A-C:
 - A. purpose is to allow participation in, or receive profits from, acquiring/holding/ managing/disposing of the property
 - B. participants don't have day-to-day control over management of property
 - C. reasonable investor expects to realise investment on a basis calculated entirely or almost entirely by reference to NAV of property or an index.

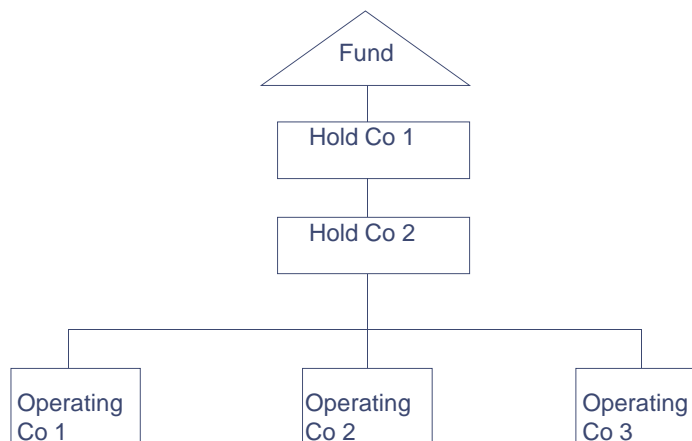
New definition of offshore fund

- **Exceptions**

A reasonable investor participating in the arrangements would expect to be able to realise all or part of an investment in the arrangements [on a NAV basis] only in the event of a winding up, dissolution or termination and Condition X or Y is met:

- Condition X is that the arrangements are not designed to terminate on a date stated in or determinable under the arrangements
- Condition Y is that the arrangements are designed to wind up, dissolve or terminate on a date that is determinable but
 - either there are no income producing assets,
 - or the participants in the arrangements are not entitled to income from the assets
 - or any income generated by the assets is required to be paid or credited to the participants in such a way that a participant who is an individual resident in the UK would be charged to income tax on that amount.

Private equity structures and the new offshore fund definition



Next steps

- New definition enacted by Finance Act 2009 with effect from 1 December 2009
- Draft guidance issued by HMRC in May 2009
- Ongoing discussions with HMRC regarding application to PE structures and insertion of PE specific guidance

Questions and Answers

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