PANORAMIC

TAX ON INBOUND INVESTMENT

United Kingdom

Tax on Inbound Investment

Contributing Editor

Graham Samuel-Gibbon

Taylor Wessing

Generated on: October 16, 2024

The information contained in this report is indicative only. Law Business Research is not responsible for any actions (or lack thereof) taken as a result of relying on or in any way using information contained in this report and in no event shall be liable for any damages resulting from reliance on or use of this information. Copyright 2006 - 2024 Law Business Research

Explore on **Lexology**

Contents

Tax on Inbound Investment

ACQUISITIONS (FROM THE BUYER'S PERSPECTIVE)

Tax treatment of different acquisitions
Step-up in basis
Domicile of acquisition company
Company mergers and share exchanges
Tax benefits in issuing stock
Transaction taxes
Net operating losses, other tax attributes and insolvency proceedings
Interest relief
Protections for acquisitions

POST-ACQUISITION PLANNING

Restructuring
Spin-offs
Migration of residence
Interest and dividend payments
Tax-efficient extraction of profits

DISPOSALS (FROM THE SELLER'S PERSPECTIVE)

Disposal methods
Disposals of stock
Mitigating and deferring tax

UPDATE AND TRENDS

Key developments of the past year

Contributors

United Kingdom

Taylor Wessing

TaylorWessing

Graham Samuel-Gibbon g.samuel-gibbon@taylorwessing.com
Sally Robertson s.robertson@taylorwessing.com
Claire Hawley c.hawley@taylorwessing.com

ACQUISITIONS (FROM THE BUYER'S PERSPECTIVE)

Tax treatment of different acquisitions
What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?

An acquisition of business assets allows a purchaser to choose the assets and liabilities that it acquires and ensures that it does not inherit the tax liabilities of the target company. As a result, a purchaser usually prefers to acquire business assets rather than stock. However, a purchaser based outside the United Kingdom may prefer to isolate its UK tax and legal liability in the target by acquiring its stock. A UK corporate seller will often prefer a stock sale because of the availability of the substantial shareholding exemption to exempt any chargeable gain from UK tax.

Historic and continuing tax liabilities

On an acquisition of stock, historic and continuing tax liabilities (including potential secondary tax liabilities) remain with the company (becoming the purchaser's responsibility on acquisition). For this reason, a seller usually gives a tax covenant to the purchaser, allowing the purchaser to recover historic tax liabilities from the seller on an indemnity basis.

Generally, tax liabilities remain with the seller on an asset acquisition. However, where a transfer constitutes a 'succession' for tax purposes, the buyer will take over responsibility for end-of-year payroll and national insurance contributions (NICs) returns for the entire tax year in which the transfer takes place (although complications can potentially arise for certain NICs liabilities). For these reasons, it is not normal for a seller to give a tax covenant on an asset acquisition and tax warranties are generally limited to value added tax (VAT) and capital allowances, share schemes, payroll records, tax concessions and cooperation.

Transaction taxes

On an acquisition of stock, stamp duty or stamp duty reserve tax (SDRT) is payable by the purchaser at 0.5 per cent of the consideration paid for the stock (stamp duty rounded up to the nearest £5). Stamp duty land tax in England, land and buildings transaction tax in Scotland and land transaction tax in Wales (together, SDLT) is not payable. In addition, there is no VAT on the consideration.

On an asset acquisition, there is no stamp duty or SDRT charge (assuming no stock or marketable securities are transferred). However, SDLT will be payable by the purchaser (at various rates) on the purchase price allocated to the property. VAT is also payable on the purchase price, unless the acquisition involves the transfer of a business (or part of a business) to be used by the purchaser in carrying on the same kind of business as that carried on by the seller. This is known as a 'transfer of a going concern', and the VAT treatment is mandatory where the conditions are met.

Step-up in base cost

An acquisition of stock will not affect the target company's base cost in its capital assets.

On an asset acquisition, there will be a step-up in the base cost of the assets acquired. Although the purchase price must be allocated to the individual assets acquired, the allocation set out in the contract is not always determinative. For example, His Majesty's Revenue and Customs (HMRC) may challenge that apportionment as not being 'just and reasonable', any values allocated for generally accepted accounting practice purposes must be used instead for intangibles and special rules apply where a transfer is intra-group or between associated companies.

Tax assets

If a company holds valuable tax assets such as trading losses, acquiring stock enables the purchaser to acquire those assets and to use them to mitigate future tax liabilities of the company, subject to anti-avoidance rules. In contrast, on an asset acquisition, the tax assets of the company will typically remain with the seller.

Law stated - 22 July 2024

Step-up in basis

In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?

A purchaser will normally get a step-up in basis in the business assets of the target company on acquiring business assets. Where the seller is a third party, the purchase price should be allocated to the individual assets on a 'just and reasonable' basis and the purchaser's base cost will be the amount allocated to each asset plus the incidental costs of acquisition. However, where a purchaser and seller are connected parties, market value rules apply.

Whether any assets are entitled to tax depreciation (and how much) depends on the nature of the asset, the amount paid for that asset and its market value (or, in some cases, the arm's-length price).

Law stated - 22 July 2024

Domicile of acquisition company

Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?

There are many reasons why it is often preferable for an acquisition to be executed by a UK acquisition company, including:

- the UK's corporation tax rate is as at the date of publication 25 per cent on profits over £250,000 (with a rate of 19 per cent applying to profits of £50,000 or less and marginal relief available for businesses with profits between £50,000 and £250,000)

and effective tax rates can be reduced as the United Kingdom has attractive tax reliefs for research and development, intellectual property and capital allowances;

- the UK's extensive double tax treaty network is available to UK companies to prevent double taxation and reduce withholding tax (WHT) on cross-border interest, royalty payments and other payments;
- the United Kingdom has full domestic exemption from WHT on dividends and a broad exemption from tax on receipt of dividends by corporate shareholders;
- the substantial shareholding exemption will often apply on a subsequent disposal of stock to exempt any gains from the charge to tax if the conditions are met;
- tax relief for interest may be available to offset the target's taxable profits or taxable profits from other UK companies (or UK permanent establishments of non-UK companies already owned by the purchaser) subject to interest deductibility restrictions, transfer pricing and anti-hybrid rules; and
- tax losses can be transferred between group companies (subject to certain conditions).

Law stated - 22 July 2024

Company mergers and share exchanges

Are company mergers or share exchanges common forms of acquisition?

The United Kingdom does not have a mechanism to effect legal mergers of entities; and since Brexit, the EU Mergers Directive is no longer available. However, it is common for acquisitions to involve share exchanges so that the purchaser issues shares in itself to the target shareholders as consideration for the shares in the target company. The main reason for doing this is so that, commercially, the seller has a continued vested interest in the success of the target company.

For tax purposes, where a target shareholder exchanges its shares for new shares as part of an acquisition, the shareholder is not treated as having made a disposal of the old holding for the purposes of capital gains tax provided certain conditions are met (share-for-share exchange relief). Instead, the shareholder is treated as having acquired the new holding at the same time, and for the same consideration, as the old holding. In addition, any new consideration given for the new holding is treated as having been given for the old holding (thereby increasing the amount of consideration for the old holding). When the new holding is eventually sold, tax will be payable on any gain arising, subject to the availability of any tax relief.

For shareholders holding more than 5 per cent of the share capital (or of any class of shares), share-for-share exchange relief only applies if the exchange is for bona fide commercial reasons and is not part of a tax avoidance scheme.

Law stated - 22 July 2024

Tax benefits in issuing stock

Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

Where the purchaser issues shares in itself to the target shareholder as consideration rather than cash (a share-for-share exchange) provided the conditions are met (including, for shareholders holding more than 5 per cent of the share capital (or of any class of shares), that the exchange is for bona fide commercial reasons and it is not part of a tax avoidance scheme), any chargeable gain arising on the disposal of the old holding of the target shares may effectively be rolled over into the new holding of shares in the purchaser entity so that the seller can defer its tax liability until an eventual disposal of the new holding. There is generally no particular tax benefit to the acquirer in issuing stock as consideration rather than cash.

Law stated - 22 July 2024

Transaction taxes

Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

Stock acquisition

Stamp duty or SDRT is payable on the consideration paid (or stock issued or debt assumed by the purchaser) for the transfer of that stock at a rate of 0.5 per cent of the value of that consideration. The stamp duty payable is rounded up to the nearest £5 for each instrument of transfer. SDRT is chargeable when an unconditional agreement to transfer shares is made. The payment of stamp duty usually discharges any SDRT charge that arises on the same transaction. In practice, SDRT generally only needs to be paid in the context of electronic share transfers on the Certificateless Registry for Electronic Share Transfer securities depositary platform where there is no physical instrument of transfer.

Stamp duty must be paid to HMRC within 30 days of the date of the instrument of transfer and confirmation of stamping by HMRC should be provided for the instrument of transfer to be admissible as evidence in civil proceedings and for the company's statutory books to be written up.

Various stamp duty reliefs are available (if the relevant conditions are met), for example, intra-group relief, share-for-share exchange relief and reconstruction relief.

The UK government is considering modernising and consolidating the existing stamp duty and SDRT legislation, with a new single tax to replace them that is self-assessed and administered in line with the rest of the UK tax system. It has been proposed that it will be subject to clearer rules on geographical scope, tax base and calculation of liability. If reform goes ahead, we can expect draft legislation to follow and it is possible (although we expect unlikely) that change may occur during 2025.

The acquisition of stock is not subject to VAT.

Asset acquisition

Asset acquisitions are not subject to stamp duty or SDRT, assuming none of the assets are stock or marketable securities. However, SDLT in England, land and buildings transaction tax in Scotland and land transaction tax in Wales will generally be payable by the purchaser at various rates depending on whether the property is residential or non-residential and on the price allocated to the property on a just and reasonable basis.

VAT is also payable on the purchase price unless the acquisition is a transfer of a going concern.

Law stated - 22 July 2024

Net operating losses, other tax attributes and insolvency proceedings

Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

Corporate income loss restrictions

Carried forward trading losses are denied where there has been a change of ownership within three years before, or up to five years after, the losses were incurred and (among other conditions) there is a major change in the nature or conduct of the company's trade. In addition, losses can only be set against up to 50 per cent of profits and gains exceeding the annual deductions allowance of £5 million (that amount is increased in certain situations).

Insolvent companies

Where a seller business is in administration or liquidation (or some other procedure such as a voluntary arrangement or a mortgagee in possession over certain assets), special tax rules apply. If the business is still trading, its VAT registration will continue, but the appointment of administrators and liquidators is notified to HMRC. When a company goes into liquidation it will have ceased trading (which triggers certain tax implications) and have lost beneficial ownership of its assets, which can cause issues such as loss of tax grouping (which could affect the availability of group reliefs for a business on an asset sale to a subsidiary). By contrast, going into administration does not itself result in cessation of trade or loss of beneficial ownership. HMRC has preferred status as an unsecured creditor, ranking ahead of holders of floating charges and unsecured creditors for the purposes of VAT, income tax under pay-as-you-earn, employee national insurance contributions, student loan deductions and construction industry scheme withholdings (and related interest and penalties for any of these), but not corporation tax.

Law stated - 22 July 2024

Interest relief

Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility generally or where the lender is foreign, a related party, or both? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?

Corporation tax relief is available in respect of interest payments by a borrower to a lender. However, this is subject to various restrictions set out in the following that limit tax relief for net interest and other financing costs.

Corporate Interest Restriction

The Corporate Interest Restriction only applies to individual companies or groups of companies that had net interest and financing costs of over £2 million in a 12-month period. Broadly, if it applies, the company's or group's net tax-interest expense for a period of account is limited to 30 per cent of the lower of:

- its UK taxable profits before interest, taxes, capital allowances and some other tax reliefs; and
- the company's or group's worldwide net interest expense (fixed ratio rule).

In addition, the company's or group's net UK interest deductions cannot exceed the global net third-party interest expense of the group (modified debt cap).

Anti-hybrid rules

Anti-hybrid rules deny deductions for arrangements that give rise to hybrid mismatch outcomes and generate a tax mismatch. For example, mismatches can involve either double deductions for the same interest expense or deductions for an interest expense without any corresponding receipt being taxable. The rules are complex, but broadly attempt to neutralise the tax mismatch created by arrangements by changing the tax treatment of either the payment or the receipt, depending on the circumstances.

Transfer pricing and thin capitalisation

Transfer pricing rules apply to limit tax deductions, where funds are borrowed or guaranteed from a connected party, to the amount that would have arisen if the lending arrangement had been entered into between unconnected parties. The United Kingdom does not have a separate thin capitalisation regime nor a formal thin capitalisation safe harbour and thin capitalisation concepts form part of the transfer pricing regime, with HMRC considering the level of debt, interest rate and other terms that would have been agreed between unrelated parties in determining the appropriate level of interest deductions.

Law stated - 22 July 2024

Protections for acquisitions

What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments

made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient? Is tax indemnity insurance common in your jurisdiction?

Stock acquisition

A purchaser will normally seek to obtain a tax covenant or indemnity from the seller that enables it to recover the amount of any historic tax liabilities of the target company from the seller on a pound-for-pound basis. In other words, this should mean the purchaser is not out of pocket for any historic tax liabilities that the seller should have paid or accounted for during their period of ownership of the target company, and that have not been factored into the price of the acquisition by the purchaser.

A purchaser will also normally obtain a set of tax warranties from the seller. These serve a dual purpose as for:

- information gathering (primarily to ascertain if there are any potential tax issues in the target that should be reflected in the purchase price, need specific indemnity cover, and (or) action post-completion); and
- a further possible remedy if the purchaser suffers a loss as a result of a breach of warranty.

Payments by the seller following a claim under a warranty or indemnity should be treated as an adjustment to the purchase price and should not be subject to tax in the hands of the purchaser (unless the amount of the claim exceeds the purchase price) or any withholding obligations.

Warranty and indemnity insurance is frequently used to provide cover for the target company's historic tax liabilities, particularly for situations where the seller intends to distribute the proceeds of sale to investors and limited recourse is available or in distressed sale scenarios where the purchaser has no real recourse available to it. If obtained, the insurer effectively stands in the position of the seller with regard to the tax covenant and tax warranties, although the use of the insurer's standard form tax documents (synthetic tax deeds) is becoming increasingly common. It is also common for insurance policies to include strict limitations and they do not usually provide cover for known issues, secondary tax liabilities, transfer pricing issues and anti-avoidance issues unless special cover (which is increasingly available) is obtained.

Asset acquisition

A purchaser will not need a tax covenant or extensive tax warranties on the basis that, generally, the purchaser does not inherit the sellers' tax liabilities and (or) assets. Tax protections under asset purchase agreements are generally limited to a small number of warranties and VAT provisions.

Law stated - 22 July 2024

POST-ACQUISITION PLANNING

Restructuring

What post-acquisition restructuring, if any, is typically carried out and why?

Any post-acquisition restructuring is ordinarily driven by the ongoing business goals of the acquirer group and how it intends the newly acquired business to operate within it. In particular, how much the acquirer wishes to integrate the target, or the target's business, into its wider operations will be key.

Some common post-acquisition restructuring includes:

- positioning the business operations of the acquired target alongside any similar operations within the wider group (including within any fiscal unities that apply, considering the location of any employees, streamlining the corporate chain of command and simplifying any compliance obligations);
- rationalising intra-group supplies of goods and services;
- segregating different elements of the group's business into different group entities (in relevant jurisdictions) for the purposes of:

- hiving off group business (or business assets) in preparation for a future sale (or otherwise);
- separating the trading and investment activities of a group (perhaps so that trading businesses can qualify for certain UK tax reliefs, in particular, the substantial shareholding exemption and business asset disposal relief (formerly entrepreneurs' relief);
- organising the equity (and investment) profile of different parts of the business; and
- separating businesses with different risk, regulatory or commercial profiles; and
- rationalising intra-group finance arrangements (maximising available deductions for any debt financing and minimising any exposure to UK withholding tax on interest).

Achieving the commercial objectives listed above in a tax-efficient way (both with regards to the reorganisation itself and considering any future tax-leakage up the structure) should be considered as part of any reorganisation or integration strategy.

Law stated - 22 July 2024

Spin-offs

Can tax-neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?

Yes. Any such transaction may typically be effected by way of a corporate demerger or a hive-off and businesses undergoing such transactions will want to minimise any tax charges arising.

Demerger

A demerger involves the company transferring assets (being either a business or shares in a subsidiary) to some or all of its shareholders (or to a new company owned by such shareholders).

A demerger is usually effected via a dividend in specie (whether directly or indirectly). UK corporate law requires the distributing company to have sufficient distributable reserves to cover the book value of the demerged subsidiary (or the assets) in the company's accounts.

Demergers that satisfy the conditions set out in the tax legislation should qualify as exempt distributions and should not trigger charges to income tax, capital gains tax or corporation tax (either at shareholder or company level).

If a demerging company does not have sufficient distributable reserves, a demerger may be effected by reducing the capital of the demerging parent and transferring the asset being demerged to shareholders as a repayment of capital. However, for any such distribution to be tax neutral, the amount of the repayment of capital must equal the market value of the business or shares to be transferred (and certain other conditions in the tax legislation must be satisfied).

Achieving a tax-efficient demerger is complex and care needs to be taken in relation to various potential tax implications, including preservation of trading losses, mitigation of stamp duty implications etc.

Hive-off

A hive-off is frequently used when a company wishes to isolate certain business assets and sell them to a third party (ie, dispose of them out of the group).

As part of a hive-off a company will transfer the business assets it wishes to sell to a subsidiary (ie, down the corporate structure), which will normally be newly incorporated and free of historic liabilities, on a tax-neutral basis. The shares in the subsidiary company will then be sold to a third party.

As part of the hive-off, it is possible for the transferred subsidiary to use the trading losses associated with the trade that has been transferred in its future accounting periods. However, this will be subject to the transferred subsidiary continuing the transferred trade and satisfying certain other conditions within the tax legislation and such use will be subject to certain restrictions and anti-avoidance provisions. Any unused capital losses, surplus management expenses and non-trading deficits within the seller company cannot be transferred as part of the hive-off.

Although the initial transfer of business assets can typically be achieved on a tax-neutral basis, the disposal of the relevant subsidiary may trigger degrouping charges and (or) the clawback of reliefs claimed as part of the initial transfer. If the conditions for the substantial shareholding exemption are met, this may eliminate any degrouping charges.

Law stated - 22 July 2024

Migration of residence

Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?

A UK tax resident company may change its jurisdiction of tax residence. This will commonly be effected by it transferring its central management and control to another jurisdiction and, where the UK tax resident company is also UK-incorporated, relying on a residence tie-breaker provision in an applicable double tax treaty. However, the process to achieve tax migration is often difficult to navigate (especially for UK-incorporated UK tax resident companies) and should be carefully managed.

As part of any such migration:

- the migrating company will give notice to His Majesty's Revenue and Customs (HMRC) of its intention to cease to be resident in the United Kingdom and ask HMRC to approve arrangements by the company for the payment of outstanding tax liabilities;
- the migrating company will be deemed to have disposed of and reacquired all of its assets at market value immediately before it ceases to be UK resident – any resultant chargeable gain will be liable to UK corporation tax (creating an exit charge);
- such exit charge may be deferred in relation to any assets that remain within the charge to UK corporation tax (eg, assets that are attributed to a UK permanent establishment of the migrating company); and
- if the jurisdiction to which the company is moving its residence does not make a matching adjustment to the base cost of the company's assets for local tax purposes to reflect the applicable UK exit charge there will be a risk of double taxation. Following Brexit, the United Kingdom can no longer automatically rely on EU law (ie, Directive (EU) 2016/1164 (the EU Anti-Tax Avoidance Directive), as amended in 2017), to mitigate this risk.

A UK tax resident company may often be able to achieve results similar to a corporate migration from a tax perspective, but without the exit charges, by inserting a new, non-UK resident, holding company above itself (a corporate inversion or flip).

Provided that the corporate inversion is structured correctly and is not being implemented for tax avoidance purposes, it should be possible to effect the transaction without any stamp duty becoming payable and frequently without adverse tax implications for shareholders.

Law stated - 22 July 2024

Interest and dividend payments

Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?

Interest

Under UK domestic law, payments of interest that have a UK source are subject to a withholding tax (WHT) at the basic rate of 20 per cent. However, various exemptions are available, most notably:

- interest on loans less than one year in duration, unless they are capable of being rolled over into successive loans that could exceed one year;
- interest paid to a company that is either a UK tax resident or has a UK permanent establishment that is subject to UK tax on its income;
- interest paid by banks in their ordinary course of business; and
- interest paid on quoted Eurobonds (debt listed on a recognised stock exchange or admitted to trading on a multilateral trading facility operated by a regulated recognised stock exchange) or qualifying private placements.

From 1 June 2021, payments of interest to associated companies in EU countries are no longer exempt from WHT and WHT on payments to recipients in other jurisdictions may only be reduced or eliminated in cases not falling within an exemption (such as those listed) if a relevant double tax treaty applies.

Dividends

No WHT obligation arises in the United Kingdom on dividend payments, except where dividend payments are made by real estate investment trusts.

Royalties

Payments of royalties in respect of intangible assets (eg, patents, copyright, trade mark, design, etc) are subject to WHT at the basic rate (20 per cent) unless the recipient is UK tax resident or acting through a UK permanent establishment.

From 1 June 2021, payments of royalties to associated companies in EU countries are no longer exempt from WHT and WHT on payments to recipients in other jurisdictions may only be reduced or eliminated if a relevant double tax treaty applies.

Law stated - 22 July 2024

Tax-efficient extraction of profits

What other tax-efficient means are adopted for extracting profits from your jurisdiction?

The most common means of extracting profits from a UK-based company are via dividends, interest payments on intra-group loans, royalty payments and other payments for intra-group services. The United Kingdom does not generally impose WHT on payments of dividends. However, dividend distributions are not deductible for corporation tax purposes and are paid out of post-tax profits. There are company law restrictions on when a distribution can be made (sufficient distributable reserves are required and certain solvency tests must be met) and to whom (generally, distributions must be paid pro rata to all members of a relevant share class).

The United Kingdom does apply WHT on payments of UK source interest and UK royalty payments at a rate of 20 per cent. However, any WHT may be subject to relief under the UK's network of double taxation treaties and the underlying payments should (subject to anti-avoidance rules) be deductible for corporation tax purposes (noting the rate of UK corporation tax is 25 per cent as at the date of publication). Subject to the availability of treaty relief, therefore, distributions and payments of interest or royalties often result in a broadly equivalent UK tax burden. However, restrictions on the deductibility (and other tax treatment) of interest and royalties are imposed by the UK's transfer pricing and anti-hybrid rules and, further, any intra-group payment structures must generally comply with the UK's anti-avoidance provisions (which may disregard arrangements with no commercial purpose and designed wholly or mainly, for the purposes of avoiding, deferring or reducing a liability to tax).

If there is commercial justification, intercompany payments for services may also be a tax-efficient way of repatriating funds from the United Kingdom – in principle, such payments should be deductible for UK corporation tax purposes and should not be subject to either WHT or anti-hybrid rules. However, any such intercompany arrangements will be subject to the UK's transfer pricing rules and general anti-avoidance considerations, so any proposed structure should ensure that the UK entity is receiving justifiable value from entities outside of the United Kingdom in return for any payments received.

Law stated - 22 July 2024

DISPOSALS (FROM THE SELLER'S PERSPECTIVE)

Disposal methods

How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?

Where the disposal is anticipated to realise a gain, a corporate seller will generally prefer to dispose of shares rather than business assets, to benefit from the substantial shareholding exemption (SSE). The SSE will, provided certain conditions are fulfilled, exempt a UK corporate seller from corporation tax on gains that would otherwise be taxable on a disposal of shares in a trading company or holding company of a trading group (regardless of whether such shares are in a UK or non-UK resident company).

However, if the SSE conditions are satisfied, any loss arising on a share disposal does not qualify as an allowable loss for reducing the company's capital gains. As such, where a loss is expected to arise on the disposal, an asset sale may be preferred.

Law stated - 22 July 2024

Disposals of stock

Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Might a disposal of stock in a foreign holding company trigger taxes in the local company in

your jurisdiction? Are there special rules dealing with the disposal of stock in real-property, energy and natural-resource companies?

A non-resident seller will not generally be liable to UK corporation tax on any gains arising from a sale of shares in a UK company.

However, there are special rules when non-residents dispose of shares that are treated as indirect disposals of either UK real estate or UK oil and gas assets.

Subject to the relevant double tax treaty, a disposal of shares in a property-rich UK company is subject to tax on chargeable gains where the seller holds (or has in the last two years held) an interest of 25 per cent or more in such company. A company is 'property-rich' where 75 per cent or more of the gross asset value of the company is derived from UK land. However, there is an exemption from tax where the relevant land is used for the purposes of a qualifying trade that has been carried on for at least a year prior to the disposal and will continue to be carried on following the disposal.

Subject to the relevant double tax treaty, non-residents may also be subject to tax on chargeable gains on a disposal of unlisted shares that derive the greater part of their value from licences for the exploration or exploitation of oil and gas within the UK territorial sea or continental shelf.

Law stated - 22 July 2024

Mitigating and deferring tax

If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or mitigating the tax?

The SSE is the primary means of mitigating tax on gains arising from the sale of shares in a UK company. The SSE exempts the disposal by a parent company of shares in their subsidiaries from UK corporation tax on any gains where, broadly:

- the parent company is a trading company or a member of a trading group;
- the subsidiary is a trading company or the holding company of a trading group; and
- the shares were part of a holding of at least 10 per cent held for a continuous 12-month period within the two-year period ending on the date of the disposal.

Where the disposal is made by an individual or trust, the individual's or trust's tax-free allowance (as at the date of publication £3,000 for individuals and £1,500 for trusts) may reduce the gains that are subject to tax, and business asset disposal relief may be available to reduce the rate of capital gains tax on the disposal of qualifying business assets.

To the extent that a capital gain cannot be exempted, it may be possible to defer the payment of tax where, for example:

- an asset is transferred between members of the same UK capital gains group (taxable only when the asset leaves the group);
-

the proceeds from the disposal are reinvested into either certain qualifying business assets (ie, rollover relief) or shares within the Seed Enterprise Investment Scheme or Enterprise Investment Scheme;

- shares are sold in exchange for loan notes (tax may be deferred until the loan notes are redeemed or sold); or
- shares are sold in exchange for other shares (provided certain conditions are met, the seller is treated as having acquired the new shares at the same time, and for the same consideration, as the old holding).

Law stated - 22 July 2024

UPDATE AND TRENDS

Key developments of the past year

Are there any emerging trends or hot topics relating to tax on inbound investment?

The Department for Business and Trade's inward investment report for 2023to 2024 shows the United Kingdom has suffered a fall in the amount of foreign direct investment (FDI) in the past year. In large part, the economic impact of FDI is likely to have been hindered by global issues such as Russia's continuing war against Ukraine, tensions in the Middle East and rising food and oil prices. In the United Kingdom, inflationary pressure caused the Bank of England to increase interest rates to 5.25 per cent by the end of the 2023–2024 tax year. After a period of political and fiscal instability, a new Labour government is in power with effect from July 2024 with a large majority. It remains to be seen what impact that might have on inbound investment.

Law stated - 22 July 2024