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TaxTalk

Simplifying the complexities of Tax

February 2024

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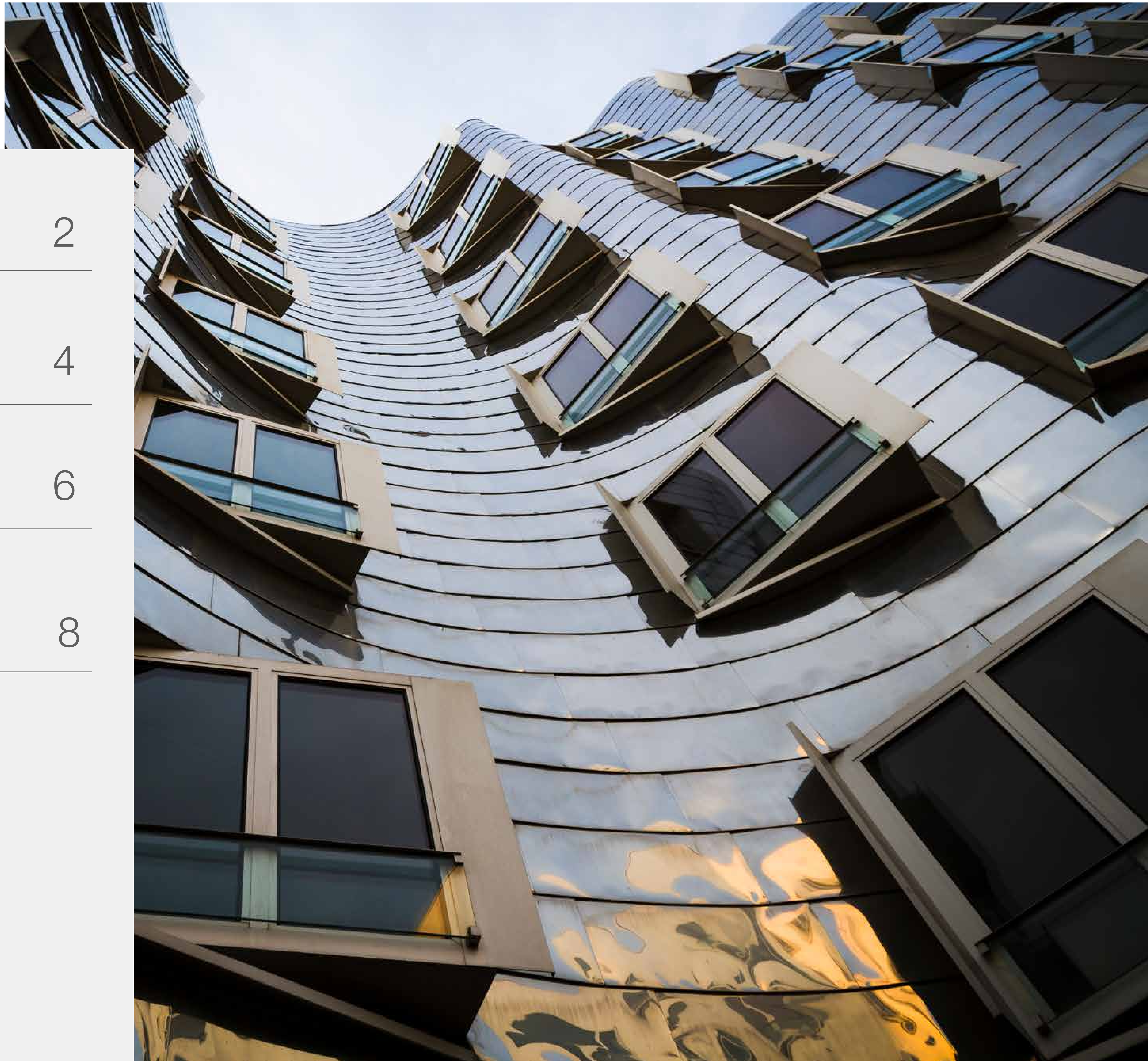


Deal fees: how to outsmart HMRC

When it's time to complete your VAT return, early preparation on your deal fees will save you pain and potentially costly penalties later.

HMRC (just like its predecessor HM Customs and Excise) has always considered 'deal fees' to be an area where it can challenge taxpayers. For example, it can block or claw back refunds of input VAT incurred on legal and professional fees relating to an M&A transaction.

In order to minimise your risk of a challenge relating to deal fees, do not 'do-it-yourself'. HMRC is likely to question your input VAT recovery request when you file a VAT return that shows a significant VAT refund on your deal fees. Or it may do so at a later date when it carries out a review of your past four years' VAT return forms.

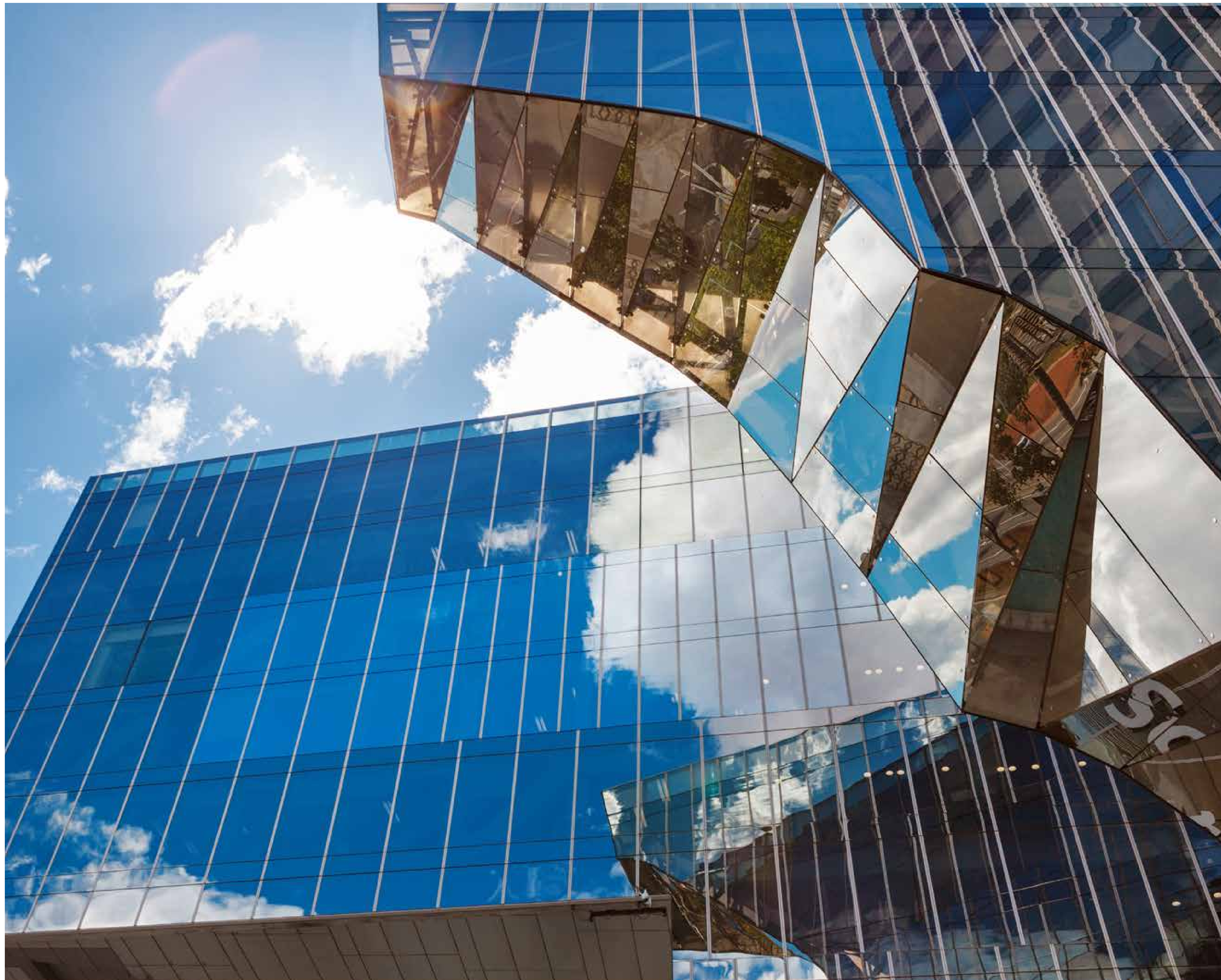
Thankfully, there is a wealth of VAT case law that gives specialist VAT advisers a road map to guide you on the recovery of the VAT incurred on your deal fees. But this body of case law is constantly evolving. So, it's dangerous to rely on what you heard from a VAT advisor several years ago, because that advice is probably now out-of-date.

Early action is always better before your deal completes. Get suppliers to credit incorrect VAT charges from their invoices before you pay them, rather than months afterwards. HMRC sets out detailed guidance on its website. So there is little excuse to get it wrong (from HMRC's point of view). Your punishment could be a penalty charge of up to 30% of the VAT bill it sends you, and an interest charge (currently 7.75% annually) on top.

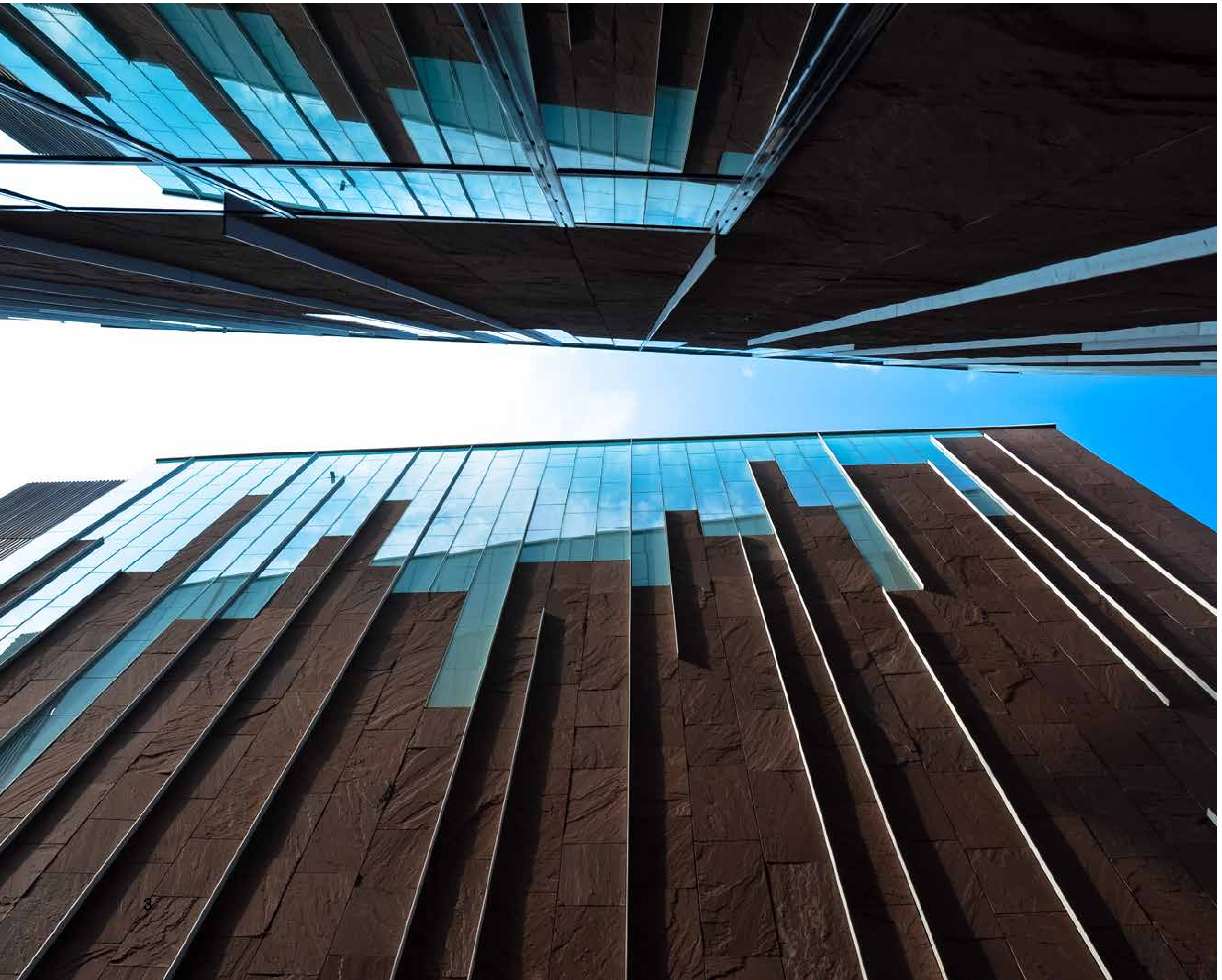
What do VAT advisors say?

- **Check whether suppliers are correctly charging VAT.** Sometimes their supplies are VAT-exempt financial intermediary services (typically provided by corporate finance advisors). Alternatively, they may be made to non-UK recipients or to UK companies with no UK-fixed establishment (for VAT purposes) and so do not fall within the scope of UK VAT.

- **Where VAT is correctly charged, check whether the right documents are in place.** Sometimes supplier invoices do not qualify as 'proper VAT invoices' as defined in VAT law and as set out on HMRC's website. Or it may be that their invoices are addressed to a company that is not named as a recipient in the legal contract for their services.



Deal fees: how to outsmart HMRC



- **If the recipient is already registered for VAT, check whether it is eligible (under VAT law) to recover input VAT incurred on its expenditure from HMRC** (not just the deal fees but other costs too). If the recipient company normally makes VAT-able supplies, then its recovery of input VAT on the deal fees should generally be accepted by HMRC (subject to the points above). The difficulty arises when HMRC considers the recipient to be a ‘non-trading holding company’.

- **If the recipient is a non-trading holding company** that only grants interest-free loans to subsidiaries and/or receives share dividends from them, **check HMRC’s website** where it sets out how such a company can become eligible to recover VAT on deal fees, such as (i) granting interest-bearing loans to non-UK subsidiaries or to UK subsidiaries that are members of the same UK VAT group registration as the holding company and / or (ii) supplying management services to subsidiaries.

What should you do next?

So our advice is to consult a specialist VAT advisor to guide you on input VAT recovery on your deal fees as soon as you can. Heading off issues before they arise is much better than trying to take corrective action months or years after your deal completes. It may be too late and HMRC could land you with a significant bill for VAT, interest and even a penalty.

For more information on any issues raised in this article, please contact Mark Ellis.

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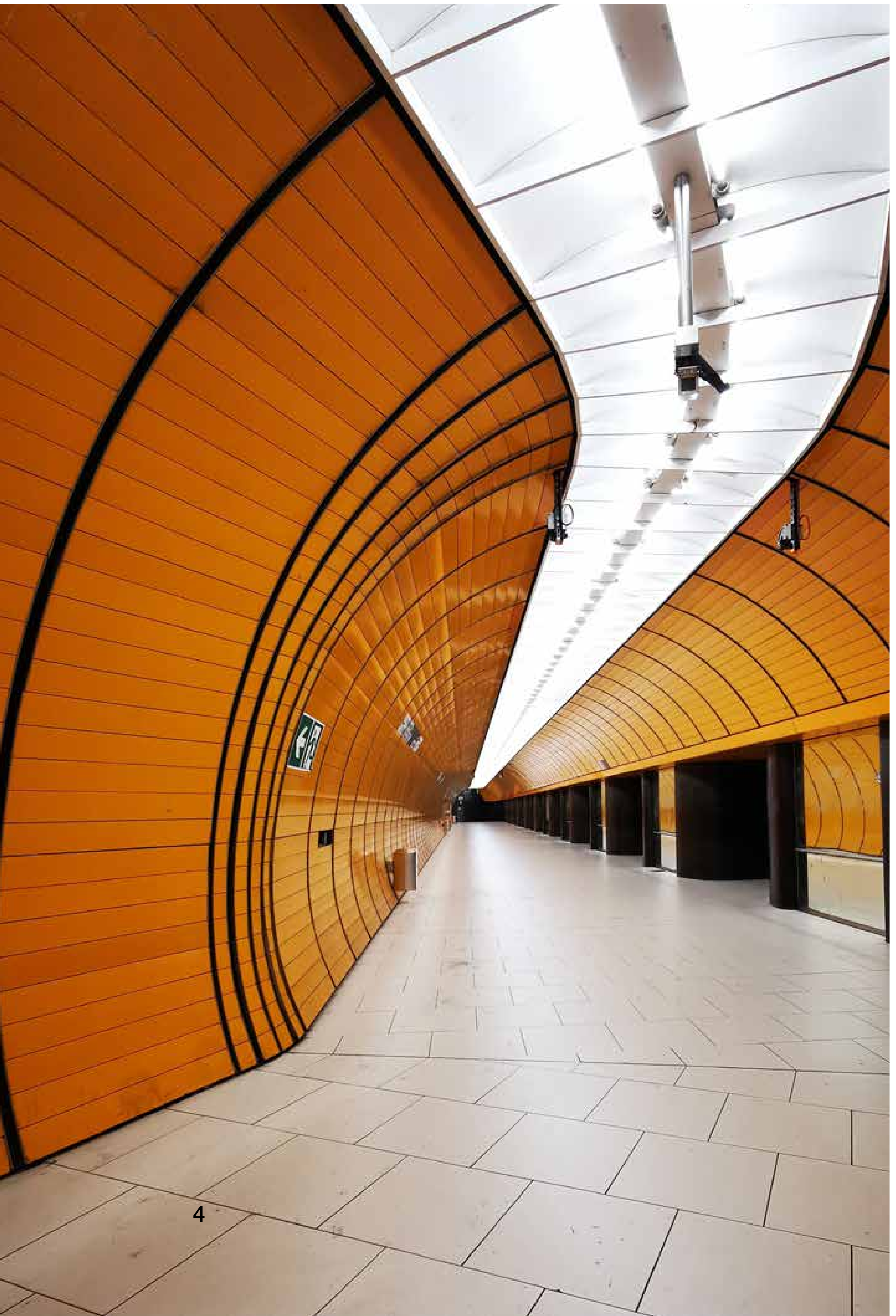
Don't sell your business short

New Year, new resolutions. If one of yours is to sell your international business, here's how to stay tax-compliant and keep complications to a minimum.



At the start of another year of business acquisitions in the M&A market, shareholders selling their businesses will be keen to understand how to make the transaction process as smooth as possible.

One way of preparing is to avoid common tax-related pitfalls, which otherwise can cause delays in the sale process and potentially hamper the purchase price. We look at some of the recurring pitfalls for international businesses below.

Overseas operations

A red flag often identified during a tax due diligence exercise is the non-registration of permanent establishments (PEs) abroad. These are also known as branches.

Broadly, a company will have an overseas PE if it has either:

- a fixed place of business outside the UK with a degree of permanence (e.g. factory, shop or office) or
- an agent who acts habitually on behalf of the company and has the power to conclude contracts overseas. This includes overseas sales agents.

Nevertheless, the storage, delivery, marketing or display of goods overseas will not initiate an overseas branch.

When a PE is created, the local jurisdiction is likely to have certain registration requirements. Non-compliance with these can lead to penalties. Following the registration of a branch overseas, profits attributable to the branch will be taxed in the local jurisdiction. Relief for any overseas tax may then be available if these profits are also subject to tax in the UK.

What's more, tax jurisdictions outside the UK may require other tax compliance which businesses aren't always aware of. Examples are sales taxes and employment taxes.

If the due diligence process identifies that the company has failed to register an overseas branch, this could trigger significant additional tax exposure and compliance requirements. Remember – it's the local legislation which will govern which taxes are relevant and which reliefs are available.

These are all considerations that must be dealt with as part of the transaction. They may result in price adjustments, additional indemnities and, in some circumstances, can delay or derail the transaction completely.

If you are thinking of selling a business, we recommend you consider any overseas operations proactively so that you can show compliance in this area.

Transfer pricing

Where transactions take place between two connected parties at a price other than what is deemed a fair market price (i.e. the price which would be charged between two parties who are independent of each other), it may trigger an adjustment in the tax calculation to reflect the difference. This includes transactions with PEs.

Small or medium-sized enterprises (SMEs) are exempt from the Transfer Pricing (TP) rules in the UK. But the exemption does not apply to transactions between connected parties in certain overseas territories. Examples of these are Gibraltar, Hong Kong and the Channel Islands. So it's a misconception to think that the SME exemption is a universal solution that excuses all such companies from the UK TP rules.

As well as the obligation to calculate taxable profits in line with TP, there is also an increasing requirement to ensure that documentation can support the pricing of transactions between connected parties.

Don’t sell your business short

In our experience, businesses often overlook this area. They may not consider transactions between connected parties for TP purposes, or there is insufficient documentation to support the pricing. These oversights may lead to inaccurate Corporation Tax returns and additional liabilities being due.

As with PEs, mentioned above, this can cause significant delays to the sale process and price adjustments on the deal or indemnity clauses.

What’s more, since a TP review should be key to a multinational’s year end routine, failure to follow these rules can raise questions around the target company’s wider control environment and compliance process.

We are primarily considering common tax pitfalls from a UK perspective. But it’s also vital to look at connected party transactions from the point of view of the counterparty’s local jurisdiction and TP requirements. Many jurisdictions do not offer companies the same SME exemption as the UK does.

Before going into a transaction it’s crucial that companies consider TP rules for all transactions between connected parties. Make sure, too, that documentation is available as part of the sale process to demonstrate this and support the pricing of these transactions.

More information on the importance of TP for start-ups, and SMEs who seek to grow internationally, can be found here.

Withholding tax on interest

As a general rule, where companies make payments of interest to an individual or overseas company, they are obliged under UK domestic law to withhold tax at 20%. But here are some examples of the key exclusions and scenarios where tax does not need to be withheld:

- Interest payments made by a UK resident company to another UK resident company
- Interest payments made to or by a UK bank
- Interest on loans which will not be in place for longer than one year
- Interest that does not arise in the UK
- Interest paid to a person/body-corporate in another jurisdiction where the double tax treaty (if any) with the UK stipulates that the rate of withholding tax can be reduced to nil.

If no exceptions apply, the interest-paying company must withhold the tax and make quarterly payments and returns to HMRC to cover the interest withheld. Even where the rate can be reduced under a double tax treaty, it’s usually necessary to apply in advance to HMRC asking for payment to be made gross (i.e. with no tax withheld).

These exclusions can be very complex and are easily overlooked by businesses. Make sure, then, that you are compliant in this area with sufficient evidence (including the authorisation from HMRC for payments to be made gross).

For more information about any of the issues raised in this article, please contact Harry Gooch.

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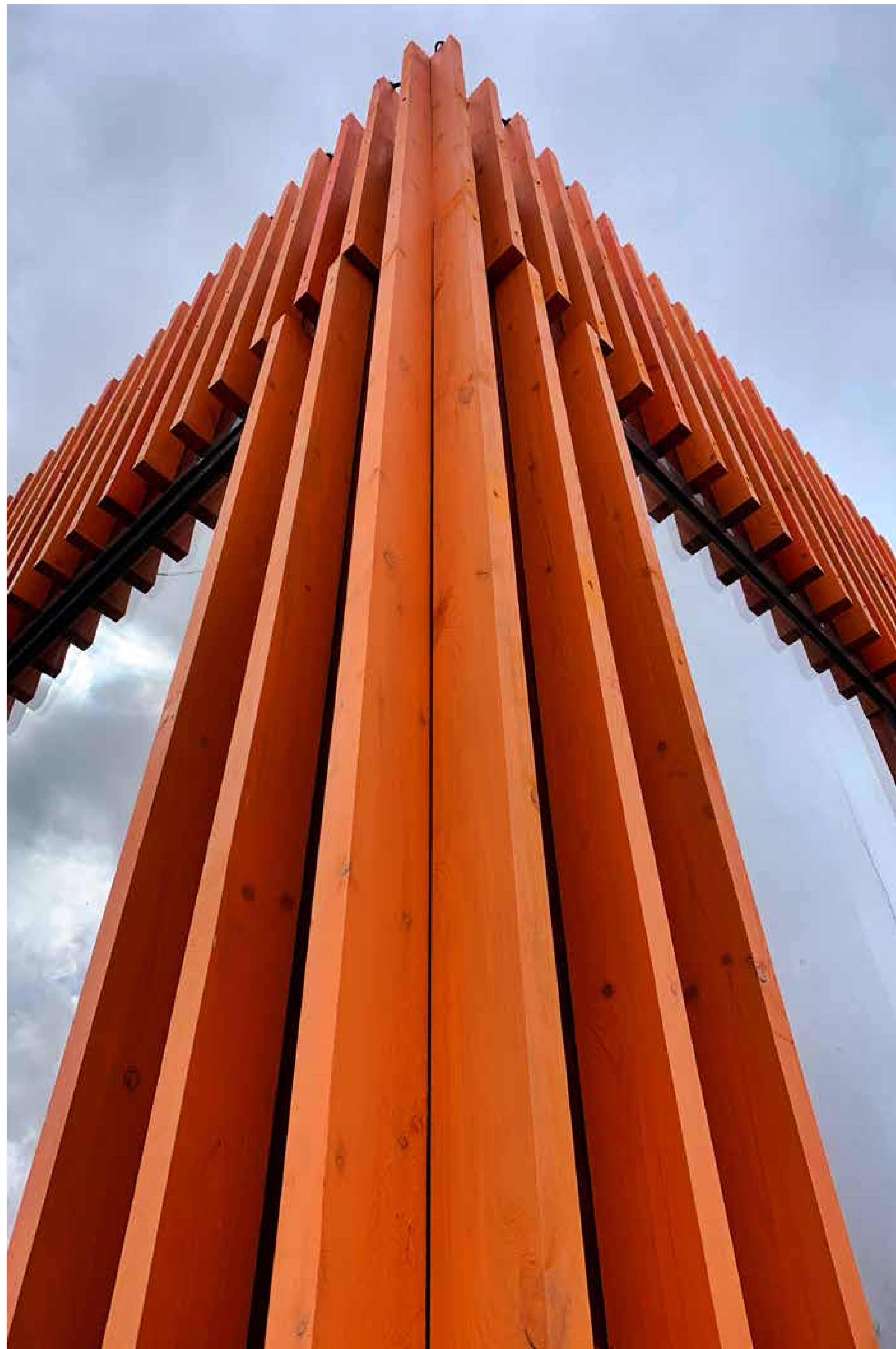

Residence nil rate band: don't miss out

None of us like to dwell on a time when we'll no longer be around. But doing the best for our beneficiaries means careful Inheritance Tax planning. Personal Tax Manager Sam Meir provides some pointers.

Inheritance Tax (IHT) tends to make headlines around election times. Being a particularly unpopular tax, cutting or scrapping it would seem like an easy political win. But it brings the Government billions every year and is relevant to fewer than 4% of deaths. The good news, though, is that the residence nil rate band (NRB) is one way many families manage to stay outside the IHT net.

What is the residence NRB?

Many people will be familiar with the standard NRB of £325,000 for IHT. It means if your estate doesn't reach this threshold, it is not subject to IHT. The residence NRB extends this by £175,000 where residential property, which was the deceased's main home at some point, is left to a direct descendant. This includes children, grandchildren, stepchildren and adopted children.

Just like the standard NRB, unused thresholds can pass to a surviving spouse. In theory, this means a married couple can have up to £1m in tax-free thresholds. If your assets are subject to IHT, the tax is currently 40%. This is a substantial rate that your descendants will need to plan for. That means the residence NRB could save a couple up to £140,000.

Am I eligible to receive it?

The first criterion is that a residential home is left to a direct lineal descendant. The amount available is the lower of the £175,000 threshold and the value of the residence passed on. If more than one residence is inherited, only one can qualify.

There is also a tapering provision which removes the relief from high-value estates. For every £2 over the threshold of £2m, £1 of residence NRB is lost. So estates worth over £2.35m will not qualify for the relief and should consider lifetime IHT planning to bring the estate value below this threshold.

It's worth noting, too, that if the residential NRB is passed to a surviving spouse, there is no taper when the first spouse dies. Tapering is only looked at on the second death. This opens up more planning opportunities.

What if my new home is worth less than the threshold?

Reliefs can be available where someone has downsized or sold their home, even if the home is no longer in the estate at the date of death.

Residence nil rate band: don’t miss out

So long as certain conditions are met, such as still passing assets to lineal descendants, there is a provision to bring relief back in line with what would have been allowed before the downsizing.

I may be subject to IHT – what can I do?

If your estate exceeds the £1m or £2.35m thresholds, there’s a good chance you will be exposed to IHT. But with some careful planning and use of generous available reliefs, it’s often possible to dramatically reduce IHT, if not completely avoid it.

IHT planning should be an ongoing process that grows and changes with your circumstances. And an important part of that process is checking whether you qualify for major reliefs like the residence NRB.

If you have any questions, or think you might be affected by Inheritance Tax and want guidance on appropriate planning, please contact Sam Meir.

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About PKF
Simplifying complexity for our clients

PKF is one of the UK’s largest and most successful accountancy brands.

We provide a full range of audit, accountancy, tax and advisory services, and are experts at simplifying complexity – we’re particularly well-known for working with large, high-profile businesses with challenging issues in fast-moving and highly technical areas.

We are also an active member of PKF Global, an international network of legally independent accounting firms that gives us an on the ground presence in 150 countries around the world.

PKF in the UK

11th largest Tax practice in the UK

£153 million annual fee income

1450+ UK partners and staff

5th ranked auditor of listed companies in the UK

Our tax services At a glance

"By bringing together the extensive expertise and experience of our tax specialists we can provide a fully rounded service that offers excellent value for money."

We offer comprehensive tax compliance and advisory services to a range of clients, both in the UK and globally, helping them find their way in the increasingly complex world of tax.

We find practical solutions that we use to our clients' advantage. Our team of experts supports individuals, and businesses ranging from start-ups and SMEs to large international groups, both listed and privately owned.

Where understanding of our clients' sector makes the difference, our experts invest their in-depth industry expertise to provide invaluable support and insights.

We offer the following specialist tax services:

Corporate and business taxes

Our Business Tax team will ensure that you are both tax compliant and efficient.

We provide specialist corporate and business tax advice on both a local and international level, which includes senior accounting officer and large business compliance, transfer pricing, transaction services, due diligence, R&D tax relief, employer solutions and global mobility. We also support both the personal and business affairs of partnerships and LLPs.

Read more

Personal tax and wealth management

Our team will guide you through the complex world of taxes, helping you meet all filing requirements and identifying risks and opportunities to help mitigate tax liabilities.

We advise individuals, the self-employed, partners, trustees and executors with their UK and international tax affairs. Our services include all aspects of tax, including Self Assessment, Capital Gains Tax, Inheritance Tax, property (both residential and commercial), trusts, family wealth and estate planning, residence and domicile issues.

Read more

VAT and Indirect taxes

Our indirect tax team will support you in meeting your VAT compliance objectives and advise you on any VAT issues that your business faces.

We can ensure that your VAT risk is assessed and managed, and that your VAT recovery is optimised. We can also provide advice and compliance services on other indirect taxes, such as Insurance Premium Tax, Customs duty, and Air Passenger Duty.

Read more

Tax disputes

HMRC is increasing the number and scope of tax investigations into both individuals and businesses, covering all aspects of potential underpayments of tax, including offshore investments, personal and corporate Self Assessment Tax Returns, PAYE and NIC compliance and VAT.

If an issue arises, our trusted advisors will match the right specialists with your needs to provide you the necessary support – whether for a routine HMRC enquiry or a more complex investigation.

Read more

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