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Answer-to-Question-_1_

To - Sara Qureshi
From - Bootle, Baker & Co
Subject - Purchase of Ordinateur Ltd.
Date - 8 November 2021

Introduction

A report prepared by Bootle, Baker & Co on 8 November 2021 for MGB Style Ltd.

This report is provided in response to a letter from Sara Qureshi sent on 29 October 2021, and is based on the information provided within her letter, on additional information provided in email from George Barnes, and the Due Diligence report.

This report is based on tax law in force on 8 November 2021.

It has been prepared for the company only, and no other person/entity may rely on its contents.

The references made in this report to -

- 'MG' mean MGB Style Ltd,
- 'OR' means Ordinateur Ltd
- 'NIC' mean National Insurance Contributions.

Executive Summary

Based on the information provided, we have estimated that MG would spend the following amounts under each option (including the £1,000,000 consideration) -

- 1) Shares purchase - £1,022,985

2) Trade and assets purchase - £1,040,800

(Please note that we would need further information in order to provide complete analysis).

The key difference between buying the shares of OR, and buying trade and assets of OR is to do with the historic liabilities. With the share deal, any historic liabilities would pass onto your business, whereas with the trade and assets deal, they would remain with the seller.

The most significant historic liability is related to the share options scheme. Under the share deal, this matter would need to be brought to a close by MG and we have therefore assumed that the liabilities would be settled on a grossed up basis to reduce the likelihood of HMRC charging penalties.

Another significant cost is stamp duty land tax, that would be payable under option 2. The stamp duty rate applicable for share sales is much lower than stamp duty land tax rates (0.5% as opposed to 5% maximum SDLT rate).

There should be no VAT implications under both options, as share purchase is an exempt transfer; and the purchase of trade and assets should meet the Transfer of Going Concern treatment (please see the below).

Under an asset deal, the TUPE regulations would apply, and all existing OR employees would need to be taken on under their existing contract terms. With a share purchase, MG would be free to take on only the employee with the right skills sets. We believe that this should also be considered.

Recommendations and next steps

1) There are advantages and disadvantages with both options.

Based on the resulting numbers, the purchase of shares seems more cost effective and attractive. However, the whole history and liabilities of the OR business would be transferred to MG. As such, depending on your financial views, we would recommend that it would be safer to proceed with the purchase of trade and assets.

Alternatively, if you are interested in purchasing the shares of OR, we would recommend to try and negotiate a lower price to compensate you for the historic liabilities.

2) Share option scheme - if proceeding with the trade and assets purchase, the exercise of the second batch of shares will give a rise to taxable employment income for all employees who were granted share options. This income will need to be processed under PAYE and Class 1 NIC withholding in 2022 on exercise (unless Ordinateur SA bring the exercise date forward). In that case, no actions would be needed.

3) The employment status of Brad should be considered following the acquisition (assuming that Brad will continue to work for MG).

4) No changes to employment contracts should be made to OR employees (under the TUPE Regulations). Their contracts should be reviewed in detail to ensure that MG have full knowledge of their employment terms.

5) Prepare for the 2021-22 P11D reporting covering the company cars (due to be submitted by 6 July 2022). Please let us know if you need any assistance with these filings.

1) Purchase of shares vs purchase of trade and assets of Ordinateur Ltd

The key difference between the two options is that with the purchase of shares, MG would be taking on the whole history, all assets and liabilities of OR.

However, with the purchase of trade and assets, MG might be able to negotiate which items are to be transferred, and which are left with the seller.

1.1 Purchase of shares

The legal aspect of the transaction under a share deal tends to be simpler compared to asset deal, although legal advice should be sought to ensure that sufficient contract terms and clauses have been considered.

As mentioned above, all assets and liabilities would pass onto MG if shares of OR were purchased. We have used the contents of the Due Diligence report provided to quantify any potential liabilities that would be 'rolled forward' into your business. Please see Appendix A for our calculations and estimated liabilities. Please note that our calculations are estimates only, and we would need further information in order to provide fuller analysis.

Under a share deal, MG would also be able to pick which OR employees are to be transferred, and which are to be made redundant. Employment contracts could also be amended to reflect your existing contracting pattern with your employees (as the TUPE regulations would not apply under a share deal). You should therefore consider whether you require all employees, and whether they can offer the right skills set.

If any terminations were to be made, these could give a rise to additional costs that would need to be considered.

1.2 Purchase of trade and assets

Under the 'asset deal', MG would essentially acquire all individual assets and liabilities of OR. You would therefore have lots of room for negotiations, and you would be free to pick which assets you want to take on.

More importantly, any tax liabilities would remain with the seller (unless you agree to take these on with the trade and assets). You would therefore have more certainty with respect to what is actually being taken on, and the risks of taking on unexpected liabilities would be minimised under this option.

All employees would transfer under TUPE regulations on their existing terms and conditions. This could give a rise to morale issues internally that you may need to address later. You would also be required to provide the same salary and benefits packages to OR employees following the transfer. Please see Appendix B for estimated costs if selecting the asset deal.

We have included further notes below, to help you follow our Appendices and our calculations. The key difference between the two purchase options is that with the share deal, any 'hidden' historic liabilities would pass onto your business, whereas, with the asset deal, these would remain with the seller.

We have also considered wider position covering other taxes below.

2) Further employment tax issues to consider

2.1 Core remuneration items

Salary

The employees of OR are on annual salary, which should not cause any issues as so are MG employees. The level of annual salaries will not be amendable under the TUPE regulations, and MG will need to continue to pay the OR employees their salaries as per their existing contracts (under the asset deal).

Under the share deal, MG could update the salary levels of OR employees as per the existing employment contracts.

Company cars

Some employees are provided with company cars. Working out the cash equivalent of a company car benefit is complex, and MG should therefore ensure that the P11D reporting has been done correctly, and will continue to be correct in the future years.

Under the share deal, MG could discontinue to provide company cars to OR employees, and sell the fleet if desired.

P11D reporting

Given the information we hold on file about MG, we believe that they may not be familiar with P11D reporting. If the trade and asset deal goes ahead, the cash equivalent of the company cars provided to OR employees will need to be reported to HMRC by 6 July following the end of each tax year.

Depending on the specifications of each car, there will be additional Class 1A NIC liability due for MG at 13.8% of the aggregate of all company car benefits. Employees would be due to settle the tax due.

Please note that fuel benefit would need to be accounted for

separately. As we do not have sufficient information at the moment, we have not included the additional costs within our cost estimation.

Please let us know if you need any further information regarding the P11D reporting process.

Laptops

From the financial information given, it appears that OR employees are provided with laptops. As long as the private use of these laptops is insignificant (for example private use in the evening after work, or over the weekend), then there should be no benefit in kind reportable. There should be no further costs, or reporting placed onto MG following the acquisition.

2.2 Contractual work location

The office premises of OR seem to be only used by Chris River. MG should therefore consider whether the premises need to be acquired (under an asset deal), or whether they could be disposed of and additional cash raised following a share deal.

Francois seems to be travelling a lot between the UK and France (his home country). This working pattern should be reviewed by MG as Francois seems to be a key individual within OR business.

Francois is currently not receiving any support from the business, and he flies between the two countries at his own expense.

It is possible to approach HMRC to agree that Francois' home in France can be classed as his permanent workplace, and that he works from home permanently. HMRC however only accept employee's

home to be their workplace, if the employee is not working from home by choice. If it could be demonstrated that travelling such a far distance between the UK and France is costly for Francois and overall impractical, HMRC may agree that Francois' home in France is his permanent workplace.

If the claim was successful, Francois would be able to deduct the additional costs of his household bills from his employment income.

Further to this, Francois may be able to benefit from the temporary workplace regime. His travel to the UK could be classed as a travel to temporary workplace, and Francois would be able to claim a deduction from this employment income for all travel, accommodation and subsistence costs.

The temporary workplace is broadly a workplace which the employee attends to perform a task of temporary nature. As Francois spends 3 days a week in the UK (Monday to Wednesday), HMRC may however challenge this arrangement, because where the employee performs their duties to a significant extent in the UK (>40% of their working time), the temporary workplace rules only apply to first 24 months.

Depending on how long this arrangement had been in place, Francois may or may not be able to benefit from this. We are happy to provide separate advice to Francois should this be of interest to him.

2.3 Share Option scheme

The share option scheme was set-up in accordance with the French legislation. No UK employment tax/ NIC obligations had been considered. Please note that the UK rules are very likely different to French tax law, and reporting to HMRC will need to

take place.

The share scheme would be operated under non-tax advantaged rules in the UK, as no agreements were put in place with HMRC covering the tax advantaged schemes.

As no reporting was done in the UK, there will be tax and potentially NIC liabilities that will need to be settled. If the purchase of OR goes ahead under share purchase deal, these liabilities would be passed onto MG. If the purchase went ahead of trade and assets transaction, then the historic liabilities would remain with the vendor. This is a key difference. We have considered the liabilities within Appendices A and B.

Background to tax and NIC charges of share options

In the UK, where employee are granted with share options, by the reason of their employment, then the these options would likely qualify as Employment Related Securities.

There is usually no tax charge on grant of the share options (even under non-tax advantaged scheme).

There is a tax charge on exercise, where the employees are obtaining shares for less than their market value on exercise. We understand that employees bought their shares for £1 per share, at the time when shares were worth £10.

As such, each employee was due to pay employment tax on 100 shares x £9 (£10-£1 paid)= £900. The ultimate tax due would depend on each employees marginal tax rate.

Paying the employment tax and NIC

As the Ordinateur SA company (i.e. the company issuing the shares) is listed on French stock exchange, the shares issued to

employees under the share scheme would be classed as Readily Convertible Assets (RCA) in the UK.

This means that PAYE withholding should have been operated on the ERS income each employee earned on exercise, i.e. £900 each. On top of that, RCAs are also subject to Class 1 NIC withholding (both employee and employer). The operation of PAYE and Class 1 NIC is employer's responsibility.

As such, there is an outstanding unreported PAYE and Class 1 NIC liability in relation to the share exercised on 1 June 2021.

Further share option issued subsequently will be exercisable on 1 June 2022 (or earlier as Ordinateur SA agreed to bring this date forward given the acquisition by MG).

As such, under the share deal, MG would be liable to settle the outstanding tax and NIC with HMRC in relation to both issues of share options. Under the trade and assets deal, this liability would remain with the vendor if the exercise date is brought forward.

Reporting the liabilities to HMRC (under shares deal)

If the shares of OR are purchased, MG will need to report the outstanding liabilities to HMRC.

As the OR employees were not on MG payroll when the shares were exercised, we would not recommend for the any payroll adjustments to be done once employees are added to payroll. Instead, we would recommend for a voluntary disclosure to be submitted to HMRC.

The outstanding employment tax and NIC should be settled on a grossed-up basis (i.e. with MG settling the employees tax, and both employees and employer's NIC). This should reduce the likelihood of HMRC charging any penalties.

The penalty range for careless errors is 0% to 30%. As the share scheme is managed by a French team, HMRC may agree that the error was careless in the UK. We have included the estimate of all liabilities under Appendix A (we have not considered interest for late paid tax, nor the penalty).

Given the MG's update record with HMRC, it may be possible to suspend any penalties for 2 years. HMRC allow certain taxpayers and business to suspend the penalties for 2 years, expecting that improvements will be demonstrated within the 2 years. In that case, HMRC would also be likely to reduce the penalty to nil after the cessation of the 2 year period.

Please note that there would be no ERS related liabilities if the trade and assets of OR were bought instead. If the exercise date of the second batch of options is not brought forward, the resulting employment income on exercise will need to be reported via PAYE in 2022.

Employer reporting (under shares deal)

If the shares deal goes ahead, HMRC may levy further penalties for non-compliance with respect to annual employer reporting.

Employers in the UK are required to submit annual return to HMRC by 6 July following the end of the tax year covering all share scheme and arrangements, reporting all shares/ options granted, exercised etc.

Annual returns are generally required even if there is nothing to report.

Based on the information given, the shares granted on 1 June 2020 were due to be reported by 6 July 2021.

2.4 Contractor - Brad Flowers

Off-payroll working rules

The engagement with Brad would potentially fall under the 'Off-payroll working' rules - also called IR35 rules.

Brad had been engaged by OR over the last 12 months to provide development support. OR would be outside of scope of these rules if they met the 'small company' definition, and met at least two of the following three conditions -

- 1) The turnover of no more than £10.2m
- 2) Balance sheet total of no more than £5.1m
- 3) No more than 50 employees

Given the financial statements provided for the period to 31 December 2020, all of the above conditions were met for that period, and OR were therefore outside of scope of the off payroll working rules. As such, there were no reporting obligations sitting with OR historically.

Following the acquisition

However, since OR will be taken over by MG, Brad will be engaged by the Group of MG and OR following the acquisition. The engagement will therefore fall into the scope of these rules, as MG will not meet the small company conditions (listed above).

As Brad is the sole shareholder and director of Flowers Ltd (his personal company), this entity would meet the 'intermediary' definition (i.e. a company owned by an individual, who holds more than 5% of the share capital).

As such, MG would be obliged to determine the employment status

of Brad following the acquisition (assuming that his contract will transfer to MG). This is based on the fact that MG would be the end user in the contractual chain - the party benefiting from Brad's personal service.

Given that Brad had only been engaged over the last 12 months, he may also work for other clients in his free-time. We would need more information on Brad's working pattern in order to provide more accurate advice. Please see our initial thoughts below.

By a way of a background, there is no legislative guidance available to help determine the employment status of a worker (the assessment should be done with a reference to HMRC guidance and case law).

We are happy to assist you with this assessment, although you could use HMRC Check Employment Status for Tax tool (CEST), which is free, online resource. HMRC have also agreed to be bound by the decisions given by their tool, as long as correct information had been inputted.

The worst case scenario here is that Brad will be deemed to be employed by MG, and MG will need to operate payroll on all payments made to Brad (i.e. PAYE withholding, NIC withholding). This is based on the fact that MG would be the party paying Brad's intermediary (and no other parties, such as agencies would be involved).

This will increase the MG's costs of Brad's engagement by 13.8% Class 1 Employer's NIC. Brad would also suffer tax charge at his marginal tax rate, and 12%/2% Class 1 Primary NIC. He may therefore want to negotiate higher payments to compensate him for these extra costs.

For the purposes of working out the future estimated costs, we have assumed that Brad would be working on average on 100 days

per year, receiving £1000 plus VAT on 100 occasions = £100,000 plus VAT. The additional cost to MG would therefore be £13,800 per year if it was concluded that BRad was akin to an employee.

This liability will be applicable in both share deal, and the trade and assets deal.

3) Wider tax implications

3.1 Share deal

Corporate tax

For the purposes of capital allowances, all assets would be deemed to be acquired at their tax written down value (rather than current market value).

The companies would be part of the same corporate tax group for loss relief and capital gains tax purposes. As both companies are profitable at the moment, there are no losses that could be transferred between the two businesses. However, as both businesses are 'asset heavy', assets could be transferred between business at nil gain nil loss (avoiding any capital gains tax implications).

Group roll over relief would also be available between the entities (applicable where one company disposes of an asset and makes a gain, that could be rolled over into another qualifying asset purchased within the relevant time frame).

MG will be assessed on any dividends received from OR going forward.

Stamp duty

Stamp Duty at 0.5% would also be due on the purchase of shares (i.e. 0.5% of £1m - £5,000).

VAT

Sale of shares is exempt supply for VAT purposes. Irrecoverable VAT might however arise in relation to this, which should be quantified and considered. Please let us know if you need further advice on the VAT aspect and we will contact our VAT team.

3.2 Trade and assets deal

The transaction would be legally more complex, as all existing contracts of OR would need to be transferred to MG. Significant funds may need to be spent on the legal aspect of the transaction.

Corporate tax

The properties would be deemed to be acquired at their current market values, instead of tax written down values - for capital allowances purposes. This would be beneficial for the company as broadly more capital allowances could be claimed.

With respect to the position going forward, MG will be subject to corporate tax on all profits generated using the assets transferred from OR.

Stamp duty

Stamp Duty land tax would be payable on any properties acquired. The freehold property was acquired for £750,000. We have assumed that this would be a reasonable estimate of current market value,

and so the stamp duty land tax for non-residential property would be -

$$0\% \times \pounds 150,000 = 0$$

$$2\% \times \pounds 100,000 = 2,000$$

$$5\% \times \pounds 500,000 = 25,000$$

Total $\pounds 27,000$.

VAT

Under normal VAT rules, a disposal of trade and assets would be standard rates supply. However, where the Transfer of Going Concern (TOGC) rules are met, there are no VAT implications on the sale. The following are the TOGC conditions -

- 1) the assets in question need to be used by the transferee in the same kind of business
- 2) the transferor is registered for VAT, and so is the transferee (or the transferee becomes registered as a result of this transaction)
- 3) if only part of the business is transferred, this part must be capable of operating as stand alone unit
- 4) there should be no significant breaks in trading
- 5) there are no consecutive transfers of the business.

Based on the information we hold at the moment, we think it is reasonable to assume that the above TOGC listed conditions would be met. As such, there should be no VAT implications. We would however need further information in order to analyse the TOGC position in full.

On top of the above, the transfer of land and property would be deemed standard rated if transferred individually (under trade and assets option). This will however be avoided as OR opted to tax the freehold building. The transferor (OR) will however need

to have a valid option to tax in place before the transaction date (we envisage that this should not be an issue given the information provided).

It is also possible to apply to have OR VAT number transferred. However, this decision should not be made lightly as the VAT history would pass onto MG with the VAT number.

Appendix A - Share deal

£

	£
Consideration	1,000,000
Stamp duty	5,000
Brad Flowers	13,800
Share option scheme (N1)	4,185
<u>Total</u>	<u>1,022,985</u>

Note 1

Unreported employment income (£900 for 5 employees) = 4,500

We have assumed that all 5 employees are higher rate taxpayers.

Grossed up tax

$£4,500 \times 40\% = £1,800 \times 100/60 = £3,000$

Class 1 NIC (13.8% plus 2%)

On the employment income - £4,500 x 15.8% = £711

On the grossed up tax - £3,000 x 15.8% = £474

Total liability - £4,185

Appendix B - Trade and assets deal

£

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Consideration	1,000,000
Stamp duty land tax	27,000
Brad Flowers	13,800
<u>Total</u>	<u>1,040,800</u>