Share purchase or asset purchase: tax issues

This practice note looks at:
1. The main tax advantages for the buyer and seller of a share purchase.
2. The main tax advantages for the buyer and seller of an asset purchase.

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Introduction: the aims of the parties

One of the first issues to be considered on any acquisition is whether the objectives of the parties will be best achieved by a share purchase or the purchase of the company’s business and assets.

Broadly, the parties should aim to:

- Maximise the net consideration for the seller at a minimum tax cost (immediate or future) to the buyer.
- Minimise the tax cost of the subsequent sale of any unwanted assets of the target business.
- Minimise the buyer’s net financing costs.
- Minimise the ongoing (annual) tax costs of the acquired and existing business, by the efficient use of reliefs.

However, the differing tax objectives of the parties cannot always be fully accommodated within the same structure.

As a broad generalisation, the tax advantages of a share purchase to the seller are likely to be greater than the tax advantages of a share purchase to a buyer. Conversely, an asset purchase will often be more tax efficient for the buyer than the seller.

In practice, any differences between the buyer and seller on fundamental points of the deal structure are likely to emerge at an early stage. Where the buyer, for whatever reason, does not want to buy shares in a company and the seller is unwilling to entertain a different structure, negotiations are likely to fail well short even of any meaningful attempt to agree heads of terms.

Other PLC tax resources

For a brief introduction to the tax issues discussed in this note, see Practice note, Share purchase or asset purchase: overview of tax issues.

For a comparison of the tax implications of purchasing shares or assets, see box, Major tax implications of purchasing shares or assets.

For more detail about the tax aspects of share purchases, see:

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Key tax factors in favour of a share purchase

It is not uncommon for the tax advantages to the seller of a share sale to drive the structure of a sale.

The key tax factor favouring a share sale from a corporate seller’s point of view is the substantial shareholding exemption (SSE). For an individual seller, the flat rate of capital gains tax of 18% is likely to be lower than the income tax that would apply if assets were sold and the proceeds extracted by way of dividend. Furthermore, if entrepreneurs’ relief is available and a claim is made, the first £1 million of gain will be taxed at an effective rate of 10%. For more detail, see Practice note, Entrepreneurs’ relief.

Where the SSE is available to a seller, the seller may be reluctant to agree to an asset sale. The tax advantages of a share purchase may lead to an asset purchase being "repackaged" as a share purchase, via a "hive down", although this has become rare in recent years, partly as a result of restrictive tax rules. See Practice note, Asset purchases: tax aspects of hive downs for more detail.

Tax advantages of a share purchase for a seller

For a seller, the tax factors in favour of a share sale include:

- **Substantial shareholding exemption.** A chargeable gain on the sale of shares will be tax exempt if the seller is a company and the substantial shareholding exemption applies (see Practice note, Substantial shareholding exemption: overview for details of the exemption and the circumstances in which it applies). No such exemption applies to an asset sale, although tax on gains could potentially be deferred by rolling the gains into the acquisition cost of certain new business assets. In addition, if capital losses are available to the seller, it can offset them against any gains.

- **Share for share exchange relief.** If the SSE does not apply, a share sale should enable the seller to defer tax on chargeable gains to the extent that the consideration takes the form of shares or loan notes in the buyer, see Practice note, Share purchases: taxation of the seller: Deferring payment of tax. This is not possible on an asset sale, although similar relief is available on an asset sale if the proceeds are reinvested by the seller in certain qualifying replacement assets (sections 152-155, Taxation of Chargeable Gains Act 1992 (TCGA 1992); see Practice note, Asset purchases: tax issues for buyer and seller: Business assets roll-over relief: chargeable gains).
In each case, the effect of the relief is generally to defer tax on any gain until the subsequent sale or redemption of the consideration shares, loan notes or replacement assets.

- **Non-UK resident seller.** A non-UK resident seller should not be subject to UK tax on any chargeable gains arising from the sale of shares as a non-UK resident seller is not within the charge to UK corporation tax or capital gains tax, as the case may be. By contrast, UK corporation tax or capital gains tax would be chargeable on gains arising from the sale of a UK business, see Practice note, Tax on chargeable gains: general principles: How chargeable gains are taxed.

- **No balancing charges.** A single chargeable gain will arise on a share sale and that gain may be tax exempt if the SSE applies. On an asset sale, the sale of each category of asset will have different tax consequences. For example, the disposal of certain assets in respect of which capital allowances have been claimed could trigger a balancing charge for the seller and the disposal of intangible assets could trigger a charge to tax on income under the tax regime for intangible assets acquired on or after 1 April 2002. (For a more detailed analysis of the tax consequences of intangible asset purchases, see Practice note, Intangible property: tax.)

- **Double tax charge.** There is a potential double tax charge on an asset sale, which arises as follows. The selling company may suffer corporation tax on chargeable gains that arise on the sale of the assets. The shareholders in the selling company may then suffer income tax on dividends paid out of any profit that is made from the sale of assets. This potential double tax charge is often used as an argument in favour of a share sale where the target company is owned by individuals. It is not an issue where the target company is owned by another UK company, as it would not be taxed on dividends received from another UK company (section 208, Income and Corporation Taxes Act 1988 (ICTA 1988)).

- **Sheltering the degrouping charge.** If a degrouping charge arises (on assets transferred to the target by other members of the seller’s group on a no gain/no loss basis in the past six years), it is possible to shelter this degrouping gain by reallocating it to one or more members of the seller’s group that have losses to set against it (section 179A, TCGA 1992). Alternatively, the degrouping gain may, subject to the satisfaction of certain conditions, be rolled-over into the purchase of certain qualifying assets that are listed in section 155 of the TCGA 1992 (sections 179 B, TCGA 1992). For more detail on the degrouping charge, see Practice note, Groups of companies: tax: Leaving the chargeable gains group.

**Tax advantages of a share purchase for the buyer**

For a buyer, key tax factors in favour of a share sale include:

- **Tax assets.** The acquisition of shares may be attractive to a buyer if the company contains valuable tax assets. For example, trading losses, surplus advance corporation tax (ACT) and capital losses may be available to mitigate future tax liabilities of the target (although this is restricted by a range of anti-avoidance legislation). The use of any remaining surplus ACT will be governed by the shadow ACT regulations. (See Practice note, Shadow ACT for an explanation of the interaction between shadow ACT and surplus ACT.) If the buyer regards these tax assets as potentially valuable to it, the benefit may be reflected in the sale price.

- **Trading losses.** The target may be able to carry forward trading losses from the period before the sale and set these against its future profits. However, this will not be the case if, within three years before or after the sale of the target, there is a major change in the nature
and conduct of the target’s trade or the trade revives after becoming small or negligible. In addition, complex rules apply to restrict carry-forward of:

- Losses and management expenses of investment companies.
- Losses of property companies.
- Capital losses.

Subject to these restrictions, some of the benefit of these types of losses may remain in the target. On an asset sale to an unconnected party, no such carry-forward of losses is possible. For more detail, see Practice note, Asset purchases: tax aspects of hive downs: Using losses post-sale: section 768 of ICTA 1988.

- **Stamp duty.** The transfer of shares attracts stamp duty at the rate of 0.5% of the value of the consideration given for the shares. This rate compares favourably with the stamp duty land tax (SDLT) rates (the maximum rate being 4%) that are charged if the asset purchase includes interests in land and buildings in the UK. (For a more detailed explanation of how SDLT applies as a tax, see Practice note, Stamp duty land tax.)

- **VAT.** A share purchase will be VAT exempt, but an asset sale may be subject to VAT if it is not a transfer of a going concern (TOGC), for example, if the buyer will not continue to carry on the same kind of business as the seller. This may be an absolute cost to the buyer if it cannot recover all of its input VAT. For more information about VAT and TOGCs, see Practice note, VAT and property: transferring a business as a going concern.

- **Capital goods scheme.** If an asset sale is a TOGC, and includes assets within the capital goods scheme (broadly, land and buildings with an acquisition cost of £250,000 or more, or items of computer equipment with an acquisition cost of £50,000 or more), the buyer will take over the seller’s capital goods scheme adjustment position that will affect future VAT input tax recovery. This may be to the buyer’s disadvantage if it has a higher proportion of exempt supplies than the seller. On a share sale, the target will continue to apply the capital goods scheme in the same manner as before the sale provided its business remains the same. (See Practice note, Buying an interest in property: tax: Capital goods scheme for background on how the capital goods scheme operates.)

- **Transfer of a going concern.** If a business sale is a TOGC and the buyer is a member of a partially exempt group for VAT purposes, the acquisition will give rise to a deemed supply and re-acquisition by the representative member of the group of transferred assets outside the capital goods scheme unless certain exemptions apply. Such deemed supply may give rise to irrecoverable VAT. This will not happen on a share sale.

### Key tax advantages of an asset purchase

There are important tax issues to be taken into account when structuring an asset purchase. These differ from those that emerge on a share purchase and it is quite likely that the seller’s aims will not match those of the buyer when it comes to considering the tax implications of an asset or share purchase.

The main commercial reason for an asset purchase, as opposed to a share purchase, is usually flexibility:
The relevant business may be a division of a company that is not separately owned.

The buyer may wish to "cherry pick" a company’s assets.

When assets are purchased, it is only those identified assets (and liabilities) that are acquired by the buyer. However, from a purely commercial perspective, an asset purchase may, depending on the nature of the business being acquired, be more complex than a share purchase due to the need to identify and document the transfer of each of the separate assets constituting the business.

Also, more consents and approvals are likely to be required than on a share purchase. For example, the consent of customers and suppliers to the assignment or novation of existing contracts may be required. If shares in a company are purchased, all its assets, liabilities and obligations are acquired (even those that the buyer does not know about).

(See also box, Major tax implications of purchasing shares or assets.)

Tax advantages of an asset purchase for the seller

For a seller, key tax factors in favour of an asset sale include:

- **Allowable losses.** If the assets are to be sold at a loss, this should result in an allowable loss that can be set against chargeable gains in the seller or, by special election, in another member of the seller’s group (see Practice note, Asset purchases: tax issues for buyer and seller: Use of capital losses). In contrast, a share sale at a loss will not give rise to an allowable loss if a gain on the sale could have qualified for the SSE (see Practice note, Substantial shareholding exemption: overview).

- **Balancing allowance.** A sale of assets, which have fallen in value more rapidly than their tax depreciation, may give rise to a capital allowances balancing allowance, or relief under the corporation tax regime for intangible assets that would not arise on a share acquisition.

Tax advantages of an asset purchase for the buyer

For a buyer, key tax factors in favour of an asset purchase include:

- **Tax liabilities.** The buyer will generally not take on the tax or other liabilities of the seller. However, on a share acquisition, the liabilities are transferred to the buyer’s group with the target company and could include secondary liability for tax owed by other members of the seller’s group.

- **Corporation tax regime: intangible assets.** If the buyer is a company within the charge to UK corporation tax (or an overseas company with a UK *permanent establishment*), it should be entitled to tax relief for accounting amortisation of the price paid for goodwill, intellectual property and other intangible fixed assets, provided (broadly) it acquires them from an unrelated party (see Practice note, Intangible property: tax: box, Expenditure on intangibles amortised for accounting purposes for details of this regime). Goodwill on consolidation arising on a share acquisition does not fall within the scope of this relief.

The interaction of the tax regime for intangible assets with the SSE brings about a greater asymmetry in tax treatment between asset and share acquisitions. Any gains realised by the seller from a share acquisition will be exempt from corporation tax if the transaction qualifies for the SSE. However, the buyer will not be able to claim amortisation relief in respect of the purchase price. In contrast, an asset purchase will be taxable for the seller.
but purchased intangibles should qualify for amortisation relief in the hands of the buyer. This means that careful structuring of the transaction could lead to substantial value being added while the wrong choice could cost significant amounts.

- **Capital allowances: plant and machinery.** The buyer will be entitled to capital allowances for qualifying expenditure on plant and machinery. Higher first-year rates may apply for expenditure on energy efficient equipment. The acquisition price for some of these assets may be higher than their current tax written down value. Therefore, an asset purchase may reduce the buyer’s future liability to corporation tax in respect of the acquired business.

- **Capital allowances: industrial buildings.** The buyer will be entitled to industrial buildings allowances (IBAs) for expenditure on industrial buildings, such as factories (but not offices or retail premises). However, IBAs are being phased out and will be withdrawn entirely from April 2011. The buyer can generally only claim relief on expenditure equal to the seller’s unrelieved expenditure at the rates of 3% (2008/2009), 2% (2009/2010) and 1% (2010/2011) per year. For more detail, see Practice note, Capital allowances on property transactions.

- **Business assets roll-over relief: chargeable gains.** If "qualifying assets", including land and fixed plant and machinery, are acquired (replacement assets), chargeable gains on other disposals of "qualifying assets" within the previous three years, or which are expected to happen within the next year, may be deferred by the buyer or other members of the buyer’s group by way of roll-over relief until the sale of the replacement assets. For more detail, see Practice note, Asset purchases: tax issues for buyer and seller: Business assets roll-over relief: chargeable gains.

- **Roll-over relief: income gains.** The corporation tax regime for intangible assets (see above) also contains roll-over provisions, allowing relief if the proceeds from the sale of qualifying intangible assets are reinvested in such assets (see Practice note, Intangible property: tax).

- **Higher base cost.** The buyer will obtain a market value base cost in the acquired assets. Therefore, the profit on a subsequent sale of such assets should be calculated only by reference to the increase in value after the time of the business acquisition. In contrast, on a share acquisition, the assets remain owned by the target and therefore retain their historic base cost which will often be low.

- **Stamp duty and SDLT.** Documents that transfer stock, marketable securities and interests in partnerships that hold stock or marketable securities will be subject to stamp duty at 0.5% of the consideration provided. The term "stock and marketable securities" in this context includes certain bearer instruments, UK shares and certain types of loan capital that have equity characteristics. Note that in relation to certain securities particular rules apply (for example, the issue of bearer instruments can attract duty of 1.5%). (See further Practice note, Stamp duty.)

Transactions involving interests in UK land (which includes buildings and fixtures on, and leases over, the land) and certain partnership interests that hold interests in UK land will be subject to SDLT at up to 4% of the consideration provided or in certain circumstances the market value of the land. (See Practice note, Stamp duty land tax.)

Other business assets typically transferred as part of a business purchase (for example, goodwill, intellectual property, trade debts and the benefit of contracts) are no longer within the stamp duty charge. This might mean that, depending on the nature of the assets in the
target, there may be no stamp duty cost for the buyer in respect of the relevant asset purchase and no need to get the business purchase agreement stamped.

**Impact of European case law on structuring acquisitions**

In addition to the tax issues outlined above, developing European case law is having a major impact on UK domestic tax legislation, which is in turn having an impact on the structuring of large UK groups.

Before the European Court of Justice (ECJ) decision in *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt (Case C-324/00)*, typical group structures generally favoured the use of numerous subsidiary companies to hold a group’s individual businesses. Although this was often disadvantageous in terms of additional administrative costs, the benefits (such as the ability to sell the relevant subsidiary shares exempt from chargeable gains) often outweighed these costs.

Now, however, following the *Lankhorst-Hohorst* decision, there is a further significant tax burden on such structures. The ECJ decision led the UK tax authorities to change their tax rules so that arm’s length transfer pricing and *thin capitalisation* requirements on intra-group transactions now apply between large UK companies in the same way as they previously applied to cross-border situations.

These rules mean that each company will need to:

- Analyse all its intra-group transactions.
- Formally document the contractual relationships.
- Regularly review pricing terms to ensure that they are at market rates.
- Keep documentary evidence to demonstrate that this has all been done.

Failure to comply with these rules may result in tax adjustments and penalties. However, in many cases the net impact will be broadly neutral.

One way of avoiding this burdensome extra administration, as well as the possible tax exposures resulting from these rules, is simply to put all UK activities into a single company. The obvious effect of such a move will be that a seller that wants to dispose of any of the businesses will have no option but to sell the business by way of an asset deal rather than a sale of shares. The unfortunate seller in these circumstances will lose the benefit of the SSE that is only available on the sale of shares.

It is too early to say whether the effect of this legislation will be an increase in asset over share sales, as there are many other factors that are relevant in determining the form of a transaction and the optimal group structure of the acquiring company.

For a more detailed discussion of the *Lankhorst-Hohorst* decision and an explanation of the changes to the UK thin capitalisation and transfer pricing rules, see Practice note, *Thin capitalisation and transfer pricing: Changes to the UK thin capitalisation and transfer pricing rules: profits arising on or after 1 April 2004.*
Boxes

Major tax implications of purchasing shares or assets

The following table sets out the major implications for a taxpayer who purchases shares or assets.

<table>
<thead>
<tr>
<th></th>
<th>Purchase of shares</th>
<th>Purchase of assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Possible share for share exchange relief for seller if securities received as consideration</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Business assets roll-over relief for buyer on previous asset sales</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Availability of tax losses</td>
<td>Yes*</td>
<td>No</td>
</tr>
<tr>
<td>SSE for corporate sellers</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Entrepreneurs’ relief for individual sellers</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Tax relief on intangible assets for buyer (and possible roll-over into intangible assets for seller)</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Step-up of asset base cost</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Crystallisation of taxable gains in the target company</td>
<td>No (except where section 179 of TCGA 1992 applies)</td>
<td>Yes</td>
</tr>
<tr>
<td>Seller may suffer double tax</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Seller may suffer balancing charges</td>
<td>No</td>
<td>Yes (except in hive down)</td>
</tr>
<tr>
<td>SDRT/stamp duty and SDLT</td>
<td>0.5% of the value of the consideration</td>
<td>Up to 4% of the consideration for UK land and buildings and certain partnership interests</td>
</tr>
<tr>
<td>VAT</td>
<td>No</td>
<td>No, provided sale is a transfer of a going concern</td>
</tr>
</tbody>
</table>

* Subject to anti-avoidance provisions.
Article Information

RESOURCE INFORMATION

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References

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