

Ensuring a good deal

Alex Millar analyses the rules on VAT and corporate transactions.

Many clients buy and sell companies, an activity that can incur a significant amount of professional fees, often referred to as deal fees. This article provides an overview of the rules on VAT on such fees as they relate to the type of transactions readers are most likely to come across.

Exempt services

The VAT exemption is relevant to two categories of corporate finance services – transactions in shares and loan finance.

Share transactions

For intermediary services to qualify for VAT exemption in the context of share transactions, the services must be central to the negotiation or co-ordination of the transaction, and will typically involve introducing the buyer(s) and seller(s) to each other and negotiating the terms of the deal. The fact that a buyer and seller may already know each other does not in itself prevent the services qualifying for VAT exemption. Services may include:

- co-ordinating the work of other parties involved, for example, lawyers;
- carrying out any necessary consultations with regulatory authorities;
- acting as the central point of contact and execution between the sellers/issuers and their advisers and the purchasers/investors and their advisers; and
- the provision of advice.

If the above services are not part of a supply the predominant element of which is the provision of intermediary services, they will be subject to VAT. Whether or not a transaction completes does not in itself affect the VAT treatment.

Key points

- Which corporate finance services qualify for exemption from VAT?
- The conditions for VAT recovery.
- A holding company intended to make supplies should be registered for VAT.
- Bear in mind stamp duty land tax when acquiring a building.



Loan finance

For intermediary services to qualify for VAT exemption in the context of loan finance the intermediary must bring together the borrower and the lender and perform work preparatory to the conclusion of the loan contract. Preparatory work is essential for the service to qualify for VAT exemption.

Examples include:

- assisting the client complete the loan application documentation;
- preparing cash-flow forecasts relevant to the loan application; and
- negotiating the terms of the loan.

If the above services are not part of a supply the predominant element of which is the provision of intermediary services, they will be subject to VAT. Whether or not the loan application proceeds or is successful does not in itself affect the VAT treatment.

Example 1 – Alan

Alan, an existing client, wants to sell his company and has asked his accountant to provide corporate finance services finding a buyer and negotiating the deal. An engagement letter is issued to Alan and, after the deal has been completed, an invoice will be issued. The corporate finance partner in the firm has asked if VAT should be charged. In this example the corporate finance services should qualify for exemption from VAT under VATA 1994, Sch 9 group 5 item 5. The fact that VAT should not be charged on the invoice should be considered before the engagement letter is issued.

Example 2 – Daisy

Daisy has been introduced to firm B by another firm of accountants that does not offer corporate finance services.

Daisy wants to sell her company and has asked firm B to find a buyer and negotiate the deal.

Firm B has agreed to pay a percentage of its fee to the other firm of accountants for making the introduction and supporting the transaction. The other firm would support the transaction by providing relevant information to firm B.

The fee paid by firm B to the other firm of accountants will be subject to VAT at the standard rate. The VAT will not be recoverable because it will be directly attributable to the corporate finance services which are VAT exempt provided by firm B to Daisy.

Example 3 – Judy

Judy is the director of an acquisitive holding company which has identified another company that it is interested in acquiring. An accountancy firm has been engaged by the holding company to provide due diligence services in relation to the target company. VAT at the standard rate should be charged on the due diligence services.

VAT recovery

If VAT is chargeable, the conditions for VAT recovery are relevant to suppliers of corporate finance services and their clients. The seven points listed below are general conditions for recovering VAT in the context of business costs.

- The VAT must be on costs incurred for the business activities of the entity that is seeking to recover the VAT. This condition would not be met, for example, if a holding company attempted to recover VAT on an invoice addressed to a subsidiary company that was not in a VAT group with the holding company. Other examples of when this condition would not be met include a company attempting to recover VAT on services supplied to individual shareholders or on costs not incurred for the purposes of its business activities. Letters of engagement should make it clear who is supplying what to whom. It is often necessary to incorporate a new company and register it for VAT from the date of incorporation if there is an intention that the company will acquire a subsidiary and provide taxable supplies to the subsidiary. Letter(s) of engagement should be suitably addressed to the new company and the board minutes of the new company should reflect its intention to provide taxable supplies.
- The VAT must not be blocked from recovery. This condition would not be met, for example, if a business attempted to recover VAT on the cost of entertaining UK clients.
- If the entity seeking to recover VAT is involved in any activities that are exempt, for example, corporate finance services that qualify for exemption from VAT, it will need to apply the partial exemption rules when calculating how much VAT it can recover.
- The VAT must have been correctly charged at the correct rate to the entity seeking VAT recovery. This condition would not be met, for example, if an invoice issued for corporate finance services included VAT charged on services that qualify for exemption from VAT.
- The entity seeking recovery should have the correct documentary evidence of the VAT it incurred. In the case of a client that received corporate finance services that did

not qualify for exemption, the evidence would normally be a VAT invoice correctly addressed to the client and showing the correct amount of VAT charged.

- The VAT should normally be recovered on the VAT return for the VAT period into which the tax point date on the supplier invoice falls or, if the invoice was not provided until after that return was submitted, the return for the period during which the invoice was provided. One of the exceptions to this general rule relates to VAT incurred by an entity before its effective date of VAT registration. As long as the other conditions referred to in this list are met, an invoice for services with a tax point up to six months before the effective date of VAT registration can normally be recovered on the first VAT return. This exception could be relevant, for example, if a company receives an invoice with a tax point date after the date it incorporated but before its date of VAT registration.
- The invoice on which the VAT has been charged should normally be paid in full by the entity seeking VAT recovery within six months of the due date, or for businesses using cash accounting, within the VAT period for which recovery is claimed.

VAT recovery for holding companies

Often a new company (NewCo) will be formed with a view to acquiring a subsidiary. The relevant engagement letters should be issued to NewCo and, as long as it intends to make taxable supplies, HMRC should agree to register it for VAT. Registration does not in itself provide a company with entitlement to recover VAT on costs and the seven conditions referred to earlier in this article are relevant.

An example of taxable supplies is a supply of management services, but it will be important to be able to demonstrate that the services are supplied on a commercial basis. For example, if the only people on the payroll of NewCo are the directors and they are also the directors of the acquired company, HMRC may refuse to accept that management services are being supplied. See the extract from *VAT Supply and Consideration Manual VATSC06513*.

Another example of taxable supplies made by a holding company to a subsidiary is a supply of the right to use a building that NewCo has opted to tax – see example 4.

VAT Supply and Consideration Manual VATSC06513

With holding companies, 'management charges' may be the only supplies that appear to be made. If these relate to supplies actually made the holding company is entitled to register for VAT and reclaim input tax. Therefore it is necessary to check that supplies are actually being made in order to confirm the registration is valid. Indicators that a supply is not being made include:

- No staff are employed by the holding company.
- The directors are common to both the holding company and the recipient of the services.
- The company has no business premises or assets.
- There is no visible or documentary evidence of supplies other than the invoice and/or bookkeeping entry.
- The trader is unable to specify what supplies are covered by the charge.

Example 4 – NewCo

NewCo intends to acquire a fully taxable trading company which is the tenant in a building owned by a pension fund which has opted to tax the building. The pension fund is using the building to generate taxable rental income as a business activity and has agreed to sell the building to NewCo, which intends to continue the property letting activity.

If NewCo decides to register for VAT, opt to tax the building and make the required notifications to HMRC and the pension scheme before the transfer of the building takes place or a deposit is paid that would otherwise create a tax point, it should be possible for the transfer to qualify for outside the scope of VAT transfer of going concern treatment. As NewCo will make taxable supplies of the right to use the building to the trading company on a commercial basis HMRC may allow NewCo to recover the VAT on the fees relating to the acquisition of both the building and the trading company.

“It is important to consider the VAT implications of corporate finance transactions at an early stage.”

For NewCo's acquisition of the building to qualify as an outside the scope of VAT transfer of a property rental business as a going concern these conditions must all be met:

- The buyer (NewCo) must intend to use the building for the same kind of business as the seller (the pension fund). This condition should be met as NewCo intends to use the building to carry on the property rental business currently operated by the pension fund.
- As the pension fund is a taxable person, NewCo must be a taxable person already or become one as the result of the transfer. A taxable person is an entity or individual that is, or should be, registered for VAT.
- As the transfer of the building would, if it fell outside the transfer of going concern provisions, be subject to VAT, NewCo must, by the relevant date, notify HMRC that it has opted to tax the building and also the pension fund that the option to tax will not be disapplied by the anti-avoidance provision in VATA 1994, Sch 10 para 12. The provision should not be an issue in this example as the tenant is fully taxable. The relevant date is the earliest date that a tax point could have occurred were it not for the transfer of going concern provisions.
- There must not be a series of immediately consecutive transfers of the business. This condition would not be met, for example, if NewCo, on acquiring the building and the trading company, instantly transferred the building to the trading company.

Note that stamp duty land tax is chargeable on VAT-inclusive consideration. If the conditions for transfer of going

Planning point

Discuss the VAT implications of a corporate transaction as early as possible to ensure that the correct tax is paid and recovered.

concern treatment are not met and the pension fund correctly charges VAT when selling the building to NewCo, the additional stamp duty land tax cost for NewCo could be significant.

HMRC guidance

HMRC publishes guidance on VAT recovery for holding companies. The information in *VAT Input Tax Manual* at VIT40600 and VIT64050 is particularly helpful. The following extract from VIT64050 refers to the First-tier Tribunal decision in *Heating Plumbing Supplies Ltd* (TC5489):

“The appellant set up a new holding company to effect a buyout of the appellant by its management and staff. In advance of the buyout, a new VAT group was formed with the appellant as representative member, and the new holding company included as a member. VAT was incurred on professional services commissioned by the appellant in connection with the structure and implementation of the buyout. The First-tier Tribunal found as a fact that the purpose of the management-led buyout was to motivate and incentivise staff by giving them a stake in the business, with a view to improving its growth and efficiency. It held that the facts were distinguishable from those which involved a “third party takeover”.

“The First-tier Tribunal found in a third party takeover such as that in BAA, in the absence of an intention to provide management or similar services that in their own right might constitute economic activity, professional costs associated with the takeover/acquisition of shares may not be linked with the underlying business activities.”

Conclusion

It is important to consider the VAT implications of corporate finance transactions at an early stage with a view to identifying how much VAT should be charged and how much correctly charged VAT can be recovered. The sooner this is done, the sooner it will be possible to decide whether the VAT position can be improved. HMRC has revised and is likely to continue to revise its guidance, but the specific facts of each transaction should be considered in the light of relevant HMRC guidance and statutory legislation at the time. ●

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