UK200Group

independent quality assured professionals

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Experts Update

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UK200Group

independent quality assured professionals

UK200Group expert panels and forum comprise of skilled technical advisers who work independently or as part of a multi-disciplinary business team to achieve the best possible solution for members and their clients. Each adviser brings experience from the different disciplines of tax, corporate finance, forensic accounting & dispute resolution, business strategy, business recovery & insolvency and international business.

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UK200Group tax

New capital gains tax relief and Income tax free bonuses

A new tax relief available from 6 April 2014 will provide full exemption from CGT on the sale of a controlling interest to an employee ownership trust. The 2014 Finance Bill contains provisions allowing a sale to be treated as if there were no gain or loss, subject to the following principal conditions:

- The company must be a trading company or holding company of a trading group
- The sale must be an employee ownership trust which acquires a controlling interest in the company
- Any benefit conferred by the trust on the company's employees must be on the "same terms"
- Trust beneficiaries may not include participators, i.e holders of 5% or more of the company (this includes anyone who has held 5% in the previous ten years)
- For the twelve months following the disposal to the trust, at least 60% of the company's employees must not be individuals who are participators.

There is also to be a related new tax income tax relief, under which a company owned by such an employee ownership trust will be able to pay its employees annual bonuses (on the same terms) free of income tax (but still subject to National Insurance), subject to a maximum of £3,600 per employee per year. These new tax reliefs are intended to encourage more company owners to pass ownership to employees, and then to allow companies which are majority owned by an employee ownership trust, and so not able to pay dividends directly to employees, instead to pay income tax free bonuses.

They may make a sale to an employee ownership trust an attractive succession solution, particularly where there are few (or even no) trade buyers or where a high proportion of a company's value lies in its employees.

A number of companies have already gone down this route prior to the new tax reliefs. A typical model is to establish an employee ownership trust which contracts to purchase an controlling interest, agreeing to pay for it over a period of years financed by future company cashflows which are gifted to the trust.

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HMRC's next initiative: Gross Profit Rate (GPR) Reviews

Business Economic Notes (BENs) were originally issued to Inspectors of Taxes to assist them in examining accounts. They were intended to provide a general background to the trade, with some explanation of its most important features rather than an exhaustive or definitive picture of any particular trade or profession. They were subsequently updated and re-named Tactical Information Packages (TIPs). Whilst these were withdrawn from HMRC's website, it is still possible to access the historic BENs for certain trades.

One particular area on which BENs focussed was the Gross Profit Rate (GPR) achieved. Over the years an ostensibly low GPR has been the trigger for numerous tax investigations across a wide range of businesses, the inference being that if the achieved GPR fell short of the industry norm, then in default of any other explanation HMRC would seek to attribute it to an understatement of sales.

Somewhat controversially, HMRC now wish to take their targeting of low GPRs further. For two selected types of business (yet to be announced) they intend to issue warnings with the issue of 2013/14 tax returns that if, on filing the returns, the GPRs fall below the norm the taxpayer will be expected to provide an explanation for the variance. The plain inference is that such under-performing businesses will be targeted for investigation. This pilot is being termed a "test and learn" exercise, but we suspect that it is highly likely that it will be rolled out to all businesses in due course.

It is to be hoped that HMRC's information on GPR norms is more up to date than the BENs, some of which are approaching 30 years old: but it may be nonetheless advisable to familiarise yourself with the BENs, as they do provide useful background information on certain trades and professions.

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UK200Group corporate finance

Upturn in corporate finance activity

As a result of the recovery in the UK economy gaining some momentum, we have seen an upturn in Corporate Finance activity. I think we can safely say the heady days of highly leveraged cash upfront deals are a thing of the past. It will be interesting to see how deals are structured as the recovery continues.

During the time of austerity, deals were typically structured on a more "prudent" basis. Due diligence was more thorough than ever, deals were taking longer and the consideration was paid on terms that gave buyers the most comfort. Deferred consideration has been a common feature of recent transactions. By postponing payment to a future date (or dates), a purchaser can extract better value for money. Furthermore, such arrangements filled a funding gap. In an economic climate where finance has been less readily available, deferred consideration has enabled such transactions to fund themselves.

Deferred consideration provides a number of other benefits such as:

- It will maintain the support of and incentivise the seller, where required
- It helps in structuring MBOs (in their various forms) and assists in succession planning for family businesses
- The buyer has some security for warranty claims/ negative earn-out adjustments
- It may also provide tax efficiencies, as long as the deal is structured correctly, by deferring capital gains tax.

On the flip-side, acting for a seller, deferred consideration also has risks, such as:

- A seller must think about having appropriate security in place to ensure payments are made (whether this be by way of debenture or monies held in escrow)
- If the deal is not structured properly, a seller may lose Entrepreneur's Relief
- HMRC may treat any deferred consideration/earn-out payment as income.

Also noteworthy is that recent case law has shown that linking deferred consideration to "good and bad leaver" scenarios could be unenforceable as such arrangements may be interpreted as a penalty. For example, this would occur where deferred consideration ceases to be payable to a seller in the event of a breach by the seller of restrictive covenants in a sale agreement. Careful drafting is therefore required, perhaps by stating that satisfaction of restrictive covenants is a condition before payment is made.

Transactions featuring deferred consideration are likely to continue to be more common than ever. As with any other arrangement, it is important to ensure that the terms of payment and any adjustments to them (whether as an earn-out, by reference to completion accounts or otherwise) are made clear in the relevant documentation in order to avoid any dispute after completion.

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How does a business deal with an approach by a potential purchaser?

Many of the transactions we work on have been instigated by an approach from a potential purchaser. For this purchaser the unsolicited approach represents a great opportunity to secure a good business, for a reasonable price, without the extra transactional risk associated with a competitive bid - therefore although flattering to be approached, it is a more common occurrence than owners might expect.

So upfront they have two initial choices – get a professional corporate finance adviser involved or not. Clearly we on the panel would advise on option one but if they choose to manage this early stage of the transaction themselves this would be our advice:

1) Understand who has approached you – what is their motive, is it genuinely to make an acquisition? If it is can they afford you? Don't be afraid to ask them questions before progressing.

2) Don't rush to the next stage – your early actions will set foundations for the nature of negotiations to follow. Put simply, play hard to get and put the onus on them to make headway. Remember they approached you for a reason.

3) Put a confidentiality letter in place – I would expect the acquirer to be able to offer one, but it is your information and it should be on your terms.

4) Share information wisely – to the acquirer, no matter what confidentiality letter is in place, the information you share will be useful.

5) Always think about value – any information you share, especially any forecasts, can be held in evidence against you in later negotiations. Take time over the presentation of numbers and make sure you present your business in the best possible light.

6) Never disclose any price expectation – they approached you, it is for them to decide your worth.

7) If discussions are progressing get professional advice. A corporate finance adviser will help you maximise your negotiating position, will assist in agreeing a deliverable transaction and ultimately increase the probability that the transaction happens.

8) If discussions cease, ask for the return of your confidential information or for an undertaking that it has been destroyed - most importantly part on good terms, there may well be a next time.

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UK200Group
forensic accounting & dispute resolution

Fraud – An update

Having been engaged to investigate a number of different frauds over the last few years, I thought it may be useful if I shared some of the lessons I learned from these experiences.

Hindsight is a wonderful tool, especially with the colleagues of any fraudster. Well worn phrases such as "I always wondered how they afforded such holidays" and "well he did drink too much" used to appear regularly as the causes of fraud were often, greed or addictions

My recent experiences have thrown up a new addictive threat which is often difficult to spot and that is an addiction to on-line gambling. There are no expensive cars, empty bottles, glazed eyes or racing papers to alert colleagues to addiction, just a relentless way of losing money by any electronic means possible.

Combating fraud is a constant battle, with fraudsters finding new ways to extract money from their companies. With modern methods of payment including internet banking, finding traces of the fraud can often be difficult.

However it is often the old fashioned control techniques that assist in deterring or detecting such crime.

1) Segregation of duties. With companies routinely reducing accounting departments in line with the growth of IT, it is increasingly important that the setting up, processing invoices and payment of suppliers is segregated.

2) Password control. Passwords should be routinely changed.

3) Useage and exception logs. Thorough reviews of who is processing changes to standing data, who is accessing different parts of the system are vital.

4) Authorisation. A signature proves nothing if the signatory does not actually look at what he is signing for, scepticism is an underrated control. Similarly, ensuring invoices are annotated to indicate approval and payment may seem outdated but it can prevent invoices being used more than once.

5) Analytical review. Reviewing variations from the norm is an important tool and if in doubt a review of individual nominal ledger transactions is recommended. Recurring items, regular "corrections" and round sum payments are a few of the areas to look at. In one instance I investigated, the entity involved could have detected the fraud earlier by looking at the many thousands of pounds going through a petty cash control account that had a limit of hundreds.

Although some frauds are very sophisticated, a lot are not, and simple procedures could help prevent and detect problems earlier.

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Business valuations – is there a correct earnings basis?

As a forensic accountant and expert witness, I have, over the years, seen much written about the various methods used for valuing businesses, including net assets, some form of earnings, dividend yield and discounted cash flow (DCF). For each of these there are pros and cons and some have limited applicability. Accepting the limitations and that the availability of reliable information to attempt a meaningful valuation under one or other can often be an issue, in my experience many valuations are, in practice, based on a measure of earnings or future maintainable profit. This being so and accepting that a history and/or forecast of profits is present, then which measure of earnings should be used.

Three alternatives tend to be put forward:

1. Profit after tax (PAT)

2. Earnings before interest and tax (EBIT)

3. Earnings before interest, tax, depreciation and amortisation (EBITDA)

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Profit after tax has historically been used in the UK, EBITDA was the preferred measure in the US, whilst EBIT tries to bridge the gap. PAT whilst simple to understand is accused of ignoring how a business is financed and deals with capital acquisitions. EBITDA not only considers how the business might be financed and how capital acquisitions are paid for, it also takes into account depreciation and amortisation which are non cash charges against profit. EBIT is the piggy in the middle and has growing popularity; however valuation often requires some form of benchmark in order to make a meaningful comparison.

The UK200 Group Valuation Index, provides both PAT and EBITDA measures, the Private Company Price Index (PCPI), having historically provided PAT measures has now moved to EBITDA only, whilst the Price Earnings Ratio Database (PERDa) uses EBIT. Adjusting company/business profits so that they can be compared against all three measures is not normally rocket science and so rather than spending time arguing which is the most relevant, why not spend the time considering the target business against each of the measures and see what transpires. In my experience the results will often be similar and not as dramatically different as some will have you believe.

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Strategic planning or business planning?

A frequently asked client question concerns the differences between a Strategic Plan and a Business Plan. An understanding of the difference is important to ensure the document achieves maximum effect.

Strategic Plans:

- An overarching plan that sets the strategic direction of the organisation.
- Primarily used as an internal planning tool, although it may be shared with users or external stake holders. It can be used to motivate, inspire and lead staff and volunteers, and to communicate the future direction of the organisation to users and funders.
- A strategic plan can therefore lend itself to a range of presentation formats. Organisations can choose the format that best reflects their culture and approach.
- A strategic plan can provide a basis for more detailed planning including business plans, marketing strategies and funding strategies.

Business Plans:

- A business plan is an externally focused document that provides more detailed information on the proposed development of an organisation, and is likely to be shared with potential investors, lenders and funding
- A business plan will usually include more detailed information on the financial position of the organisation, financial forecasts, and competitor and market analysis.
- A business plan is more formal and detailed in its structure and contents.
- It may be more difficult to present the level of detail required within a business plan in a pictorial format, for example.

The purposes and style of the strategic plan

- The Strategic plan should tell an interesting story but... it should be non-fiction!
- The contents of the strategic plan should relate to a 3 - 5 year period of future development. A strategic plan is asking (and helping) the reader to imagine and project. However, the vision which the Plan describes must be grounded by experience and information gathered from the work which has been done in the past.
- The Strategic plan can use words, pictures and numbers to involve the reader, make the information more accessible, and the future more achievable and exciting.

Finding a 'tone of voice' which actually speaks to the readers will help them to see things from the organisation's point of view. . It may be helpful at this stage to think about any documents produced by your organisation about its work, achievements or future plans.

- Are they attractive, readable, illustrated, lengthy, wordy, colourful, digestible, worthy but dull, engrossing?
- Think about how you have arrived at your assessment - is it the design, layout or font?
- The style of writing, approach to the reader, inclusion of different points of view or 'voices'?

Function, style, content and purpose of documents are key concepts which underpin effective communication. This is essential from an internal and external perspective.

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UK200Group business recovery & insolvency

Have you received a Referral fee from an Insolvency Practitioner? If so read on…

Referral fees in Insolvency (or commission payments) can take many forms but are in essence payments (of one form or another) made by Insolvency Practitioners (IPs) to accountants and others for the introduction of work. It is not clear how widespread such payments are, however all of us at one point or another will have heard of the practice, indeed I have been asked on many occasions "what do you pay then? so and so pays me 10% of their fees". Often the answer "nothing I am afraid" fails to illicit much enthusiasm, however the follow up "because I wouldn't do anything to put your livelihood at risk" tends to prick their curiosity.

It is of course perfectly acceptable for an IP to pay a third party for assistance, but the charge has to be reasonable and commensurate with the work undertaken. It also has to be disclosed. For example it is common practice for IPs to pay accountants for assistance in production of the Statement of Affairs.

IPs, like accountants, are regulated professionals, and are subject to the code of conduct/ethics of their regulatory body. The payment of commissions for the introduction of insolvency work is usually prohibited under such codes. Indeed a "Corrupt Inducement affecting appointment" is an offence under the Insolvency Act 1986 when made to a creditor. In an insolvent position how many accountants are NOT a creditor? If to pay such an inducement is an offence, it therefore follows that to receive such a payment will mean that the recipient is receiving the proceeds of a crime. As payment of commissions to secure work is likely to be a breach of an insolvency practitioner's code of conduct, conversely the receipt of such payments may amount to a breach of the receiving accountant's code of conduct.

This is not necessarily just a regulatory issue or an Insolvency Act issue. Wider and more forceful provisions are to be found in the Bribery Act. A bribe is anything which induces someone (including in commercial situations) to carry out their duties improperly. In the case of referral fees the accountant (for example) will have a duty to act impartially in the interest of their client. The offer of a commission clearly prejudices their impartiality in choice of IP. Even if the accountant claims that his judgement was not affected he might be accused of having procured a 'facilitation payment' which would also be illegal under the Act. Under the Bribery Act both the giver and the receiver of a bribe commit an offence. Penalties are not just regulatory. Potentially there are unlimited fines and jail terms as well as confiscation proceedings. The payment of referral fees may be an open secret within a firm, as such an Accountant who accept such payments should keep in mind that they leave themselves exposed by a disgruntled whistle-blowing employee.

To ensure that you are not unwittingly putting your career at risk it makes sense to always seek insolvency advice for your clients from a UK200Group member. We won't put your career at risk and will look to offer impartial, innovative and professional advice.

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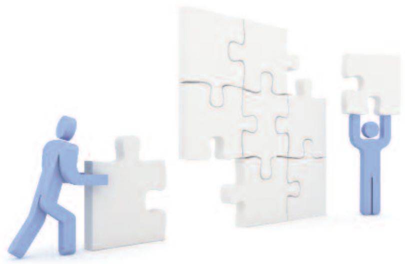

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The UK is open for business

Having recently presented at a number of UKTI seminars in Europe on UK inward investment, it is increasingly evident that the UK is becoming the destination of choice for international businesses looking to expand their operations.

Key strengths of the UK are:

The UK has a large domestic market and with no barriers to free trade in the EU it is a great springboard to mainland Europe.

The UK is one of the easiest places to set up and run a business and is ranked as a top 10 country for Ease of Doing Business in the 2014 World Bank/International Finance Corporation economy ratings.

The International Monetary Fund predicts that Britain will be the best performing of the world's major economies this year with growth of 2.9%.

When the above strengths are combined with reducing corporation tax rates, a flexible labour market and an emphasis on tax breaks for businesses making capital investments, it is not surprising that now is an ideal time for investment in the UK.

Over the last few months, across Europe, the Americas and the Far East, we have experienced a significant increase in the number of international businesses being set up in the UK, and we have had many clients asking us for advice.
Here are a few key details to consider:

- Business structure is important as there are several options available, and what suits best will depend on the overall tax position of the group, balanced with the strength of desire to limit the liability for the operations to a UK subsidiary company.

- The profit of a UK subsidiary is likely to be taxed in the UK, and at 21% from April 2014, and 20% from April 2015, it can enjoy some of the lowest corporation tax rates in the EU.

- Depending on the industry, there are some generous tax advantages, such as the increased AIA to £500,00 for expenditure incurred after 6 April 2014 and R & D tax relief, which can allow 225% relief on qualifying R & D expenditure for SMEs.

- It is also important to consider from the outset any transfer pricing issues where goods or services are sold between group companies.

With more and more emphasis on global trade, this area of advice is becoming increasingly important, and as business advisors we need to be ready to handle queries and offer advice on the most efficient structure for companies looking to invest in the UK.

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OECD model tax convention

As a member of the UK200 International Panel, it behoved me to attend an IAPA Fly-In/Fly-Out Seminar at long last and I duly did so earlier this month in Rome to hear a presentation by Ton van den Hoven on the subject of interpreting double tax treaties in the context of the well-established OECD model.

This might seem potentially the driest and dustiest subject under the sun but Ton gave a lively presentation on the subject digging into the 31 articles that make up the long established model and giving food for further thought in interpreting them.

The key point to take is that, whatever the treaty says, a knowledge of each respective country's own laws and interpretations is fundamental in each and every case, particularly insofar as definitions of simple terms such as income and royalties are concerned. In some countries for example, income from royalties may include equipment leasing.

There is also then the question of when is a tax not a tax. I deal particularly with cases involving France which imposes a"general social charge" (charge générale sociale) or CSG on income such as dividend income and capital gains. Although it is a direct "tax" on these

sources, because it masquerades as a charge more akin to national insurance, it is not relievable for double tax purposes. Nonetheless, it applies to people for over the age of 65 or the local country retirement age which, in ordinary events, "social charges" do not.

The basic convention also is likely to be revised in the near future, as there is a discussion draft now extant, to prevent "treaty abuse" and the principal anti abuse rules refer to "treaty shopping abuses" and clarification that tax treaties are not intended to be used to generate double non taxation.

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