Project Epsilon - Report on taxation issues for Board Consideration

This report sets out the alternative structures and implications thereof for the possible acquisitions of Innov8 South Ltd and Jamieson Ltd and considers options for the restructuring of the Händler GmbH subgroup post acquisition. The best structure for the acquisitions may be influenced by the specific circumstances of the vendors and the anticipated timescale for the acquisitions, but the information below should ensure that negotiations can be conducted on an informed basis.

1. Executive Summary

Acquisition options

- Acquisition can be of shares or the trade and assets of the companies
- Share acquisitions will mean the transfer of all assets and liabilities of the company with ownership of the shares so historical tax liabilities would be acquired thus increasing the importance of full due diligence and appropriate warranties and indemnities, although a pre-purchase restructuring through a hive-down may reduce commercial risks.

Innov8 South Ltd (Innov8)

- A share acquisition may give access to brought forward losses (subject to possible restrictions) but no other reliefs. The vendor would incur SDLT liabilities of up to £3.4 million.
- A trade and asset acquisition would give tax relief over a period on goodwill of £13.6 million worth £2.72 million at current rates, but SDLT of approximately £5 million would be payable by Compglo. The vendor would incur an immediate tax liability of £2.72 million.
- A share sale delayed until May 2016 would remove the vendor’s SDLT liability which indicates that this would be the most tax efficient option if both parties are happy with this timescale.
- If there are concerns about historical liabilities in Innov8 South Ltd, the vendor may undertake a pre-sale hive-down allowing the purchase of a clean company, although this creates additional tax liabilities.

Jamieson Ltd

- Given the stated requirement for after tax consideration of £10 million, the potential availability of Entrepreneurs Relief to Mr and Mrs Jamieson suggests that the net cost to Compglo of a share acquisition will be lower than that of an asset acquisition (£11 million rather than £11.785 million), although this saving will be offset by the potential for future tax relief worth approximately £785,000.
- Proceeding with the lower costing share acquisition would therefore be the best option in the short term due to the cashflow advantage but would be subject to satisfactory due diligence.
- Caution should be exercised when making payments to offshore accounts to ensure we do not act unprofessionally and adversely impact our reputation. Specifically we should ensure that all documentation clearly sets out the precise position and that we are not in any way assisting illegal acts or defrauding of HMRC.

Händler GmbH

1. The profits of Games Developer (Jersey) Ltd are potentially susceptible to a CFC charge in the UK. In this case the tax cost could be mitigated by transferring the activities of this Jersey
company into a UK resident development company, allowing the group to benefit from certain of these activities effectively being taxed at a lower rate through the patent box regime.

2. It might be possible to reduce future tax liabilities by maximising Research and Development Tax credit claims.

3. Tax could be saved by transferring the profitable Swedish branch out of Germany, but the French branch would need further consideration to understand if benefit is being obtained at the higher German rates for the losses.

2. Innov8 South Ltd (“Innov8”) acquisition

There are three ways to acquire this UK business. These are:

a) The acquisition of the share capital of the company,
b) Purchase of the trade and assets from the company or
c) The trade and assets of the business are hived down to a new company by the current owners and this new company is then acquired.

a) Share purchase

There would be no immediate tax relief associated with the consideration of £30 million for the shares (£130 million business valuation less £100 million debt to be repaid) paid for a share acquisition.

The consideration paid would represent our base cost for any future disposals of the shares. However, under current legislation, the availability of Substantial Shareholdings Exemption (SSE) would mean that no tax would be payable provided that the Comp glo group continues to meet the relevant criteria including remaining a trading group after the disposal.

Corporation Tax - general

There would be no impact on the activities of the company (Innov8) so capital allowances would continue to be claimed within Innov8 on the existing value of the pool.

Given the accounting results which arose in the first two periods of trading, it is likely that tax losses arose. If these have not been utilised by other members of the Gameplay group via group relief claims, they can prima facie be carried forward and offset against future profits arising from the same trade. The tax computations for the accounting periods to date should be reviewed as part of due diligence work to identify the quantum and availability of any losses. Whilst a value could potentially be attached to any available losses, there are rules whereby if a significant change in the nature or conduct of trade occurs within three years of a change in ownership relief for the brought forward losses against future profits will be denied. The proposed activities of the company post- acquisition should therefore be considered before any value is placed on these losses.

Corporation Tax – potential transfer pricing risk

Although equity of £20 million had been invested in Innov8 in 2013, £100 million of funds were and have since been advanced in the form of loans from Gameplay South group companies, carrying interest at 5%. This could potentially be considered as a thinly capitalised company (i.e. where the debt is higher than would be expected on an arm’s length basis). As a result the deductible interest expense could be restricted to the rate that would have been paid to a third party on the amount of the loan that would have been advanced by a third party. Warranties and indemnities should be acquired in connection with the transfer pricing position in relation to previous years’ computations in case of additional tax being payable, or losses forward being reduced in amount.
If additional funds were to be advanced to the company by way of loan by Compglo to allow repayment of the existing loan, the same rules would apply. Compglo would therefore have to ensure that both the quantum of the debt and the interest rate being charged were considered representative of an arm’s length position or adjustments may have to be made in both the paying and receiving companies’ tax computations to reflect an arm’s length position.

We should also have to ensure that all movement of goods and services between Innov8 and other group members are priced on an arm’s length basis in accordance with the transfer pricing rules, or make adjustments to reflect that basis. As with the financing, this needs to be considered for future years, and warranties and indemnities obtained in connection with prior years.

The preferred transfer pricing method would be a comparable uncontrolled price whereby a transaction is priced at the same value as if it had occurred with a third party. However if there is no similar transaction with a third party, it may be appropriate to consider the overall profit arising to the group on the transaction and apportion this based on the extent of the risks and functions undertaken by each party.

**VAT**

A share sale is exempt from VAT so no VAT would arise on the purchase of the share capital of Innov8.

**Stamp Taxes**

Stamp Duty is payable at 0.5% on the value of the consideration paid for shares, meaning that £150,000 would be payable by Compglo.

No Stamp Duty Land Tax (SDLT) will be payable by Compglo Ltd.

**Vendor’s position**

Insofar as Gameplay South is a trading group the disposal is likely to benefit from SSE. Therefore no tax arises on the disposal.

A degrouping charge could arise as a result of Innov8 leaving the Gameplay group within 6 years of the transfer of the freehold properties from Gameplay Southern plc, as the original transfer would have been deemed to occur at such a value that no gain nor loss arose. However any charge will be added to the consideration for the shares and hence, if the share disposal is eligible for SSE, no additional tax will arise.

If SSE is not available, for example, due to the non-trading nature of the selling group, further tax costs could arise for the vendor on a share sale, which would affect the price negotiations.

The original transfer in 2013 of freehold properties to Innov8 from its parent company would have benefitted from the Stamp Duty Land Tax (SDLT) group relieving provisions meaning that no SDLT would have been payable. SDLT will however be charged retrospectively based on the market value of the properties at the time of transfer if Innov8 leaves the Gameplay group within three years of the original transfer. Most of the properties (30 of the 40 shops and the distribution centre) were transferred in May 2013 (less than three years ago) and as a result Gameplay Southern plc would, if it sells the shares in Innov8 before May 2016, be liable to pay a total charge of up to £3.4 million, being 4% of the total value of the properties at the time of transfer of £85 million (assuming each of the 30 shops was valued in excess of £500,000).

No SDLT degrouping charge would arise in respect of 10 shops purchased from a third party in January 2014.
b) Trade and asset purchase

The purchase agreement will set out the consideration payable for the assets of the business.

A value of £130 million for the business indicates that the probable value of goodwill in September 2015 is £13.6 million as calculated below:

<table>
<thead>
<tr>
<th>Description</th>
<th>£million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicated value of business</td>
<td>130.0</td>
</tr>
<tr>
<td>Net current liabilities and tangible fixed assets</td>
<td>5.7</td>
</tr>
<tr>
<td>Properties</td>
<td>(122.1)</td>
</tr>
<tr>
<td><strong>Value of goodwill</strong></td>
<td><strong>13.6</strong></td>
</tr>
</tbody>
</table>

Corporation Tax

The purchasing company in the Comp glo group would be able to claim tax relief in respect of the expenditure on the assets acquired as follows:

Capital allowances at 18% or 8% on integral features would be available on:

- Fixtures and fittings within the properties. As regards the fixtures, a joint election must be made with the vendor agreeing the amount of proceeds to be attributed to qualifying items and it must be ensured that expenditure on fixtures has been pooled by the vendor; without these two conditions being met, the purchasing company will not be entitled to capital allowances on the fixtures in the properties.
- The tangible fixed assets of £1 million - computer equipment will be eligible for relief at 18% per annum.

To the extent that the Annual Investment Allowance is not being used elsewhere in the group this would be available giving 100% relief on the first £500,000 of qualifying expenditure for the year to 31 December 2015. If the acquisition occurs after 1 January 2016 when the AIA reduces to £200,000, the amount of this accelerated relief will be reduced.

Tax relief would be available in respect of the consideration of £13.6 million for goodwill, either in accordance with the accounts impairment or an annual 4% writing down allowance. In the latter case, at current tax rates, this would result in a tax saving of approximately £2.72 million over a period of 25 years.

VAT

Although it is anticipated that a purchase of the trade and assets would not be a supply of goods as it would be considered to be a Transfer of a Going Concern (TOGC), the transfer of the buildings should be considered separately. The TOGC rules do not cover buildings aged three years or less or land and buildings which the transferor has opted to tax unless the transferee opts to tax these assets.

If Comp glo were to proceed with the purchase through a trade and assets acquisition, further information would therefore be required as to the VAT status of the properties. If Innov8 has opted to tax the buildings, we should also opt to tax the buildings unless there is any intention to use the buildings in the future for a purpose which could restrict VAT recovery. If it were not appropriate to opt to tax the buildings, an additional VAT cost would arise on the acquisition. On the basis that Comp glo appears to make fully taxable supplies this should be recoverable although the Capital
Goods scheme will apply to the acquisition requiring annual adjustments if there are changes in use of the buildings over the next 10 years. However there is also an impact upon the SDLT cost – see below.

Stamp taxes

SDLT would be payable by the purchasing company on the consideration for the properties. Assuming that each of the retail properties is valued in excess of £500,000, the SDLT will be at the rate of 4% and will therefore be £4,884,000 (£122.1million @ 4%)

If it is not considered appropriate to opt to tax any of the properties in respect of which Innov8 has exercised the option, VAT will be charged on the purchase and the SDLT must be calculated on the VAT inclusive amount of the affected properties, increasing the acquisition price in each case by 20%.

Vendor’s position

On disposal of its trade and assets Innov8 would be liable for Corporation Tax on trading profits and chargeable gains.

The £13.6 million receipt for goodwill would be fully taxable, as an intellectual property trading credit with no deductible cost as it was internally generated in the Gameplay group. If the losses in the early periods of trade have not been used elsewhere in the group they may be available to reduce the tax arising on this income.

The disposal of the properties would result in individual chargeable gains calculations based on the acquisition dates to the group, as Innov8 will have effectively inherited the original base costs and acquisition dates from the transferring group company. We can estimate the position on a portfolio basis as follows:

<table>
<thead>
<tr>
<th></th>
<th>Distribution centre £’million</th>
<th>Retail properties £’million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds</td>
<td>2.1</td>
<td>120</td>
</tr>
<tr>
<td>Original cost</td>
<td>(1.8)</td>
<td>(82)</td>
</tr>
<tr>
<td>2014 Additions</td>
<td></td>
<td>(35)</td>
</tr>
<tr>
<td>Unindexed gain</td>
<td>0.3</td>
<td>3</td>
</tr>
<tr>
<td>Indexation from 2005 ((265.9-192/192)=0.385) – restricted</td>
<td>(0.3)</td>
<td></td>
</tr>
<tr>
<td>Indexation from 2014 ((265.9-252.6/252.6)=0.053 x 35)</td>
<td></td>
<td>(1.8)</td>
</tr>
<tr>
<td>Indexation on transferred portfolio (at least (265.9-250/250)=0.0636 x 82) based on ownership prior to May 2013 so restricted to</td>
<td></td>
<td>(1.2)</td>
</tr>
<tr>
<td>Gain</td>
<td>Nil</td>
<td>Nil</td>
</tr>
</tbody>
</table>

c) Hivedown

The third alternative would be for Innov8 to hive the trade and assets down to a new subsidiary (Newco). The Compglo group would then purchase the new subsidiary with the possible advantage of reducing the exposure to historical trading or other liabilities in Innov8, subject to legal review and protection through warranties. The tax implications of this alternative for Compglo are largely identical to those of a direct share acquisition of Innov8 set out above, although there are some important differences. Any trading losses of Innov8 will be transferred with the trade to Newco and hence access to these will be available as in the case of a direct purchase of the share capital of Innov8 (subject of course to the rules restricting the use of brought forward losses where is there is a change in the nature of the trade) Plant and machinery will be transferred at tax written down value and capital allowances will be available to Newco. The vendor is able to benefit from SSE on the disposal of the shares in Newco even though the shares in the new company will not have been held for a 12
month period. This will also exempt the degrouping charges arising in respect of the properties transferred intragroup from Innov8 to Newco. Degrouping charge will arise in Newco in respect of goodwill transferred from Innov8 to Newco and SDLT group relief not likely to be available in respect of properties transferred from Innov8 to Newco if arrangements are in place at the time of the transfer for Newco to leave the Gameplay Southern group (giving rise to an SDLT charge in Newco). The hive down route is likely to create additional charges in Newco which would not have arisen in case of a direct purchase of the shares of Innov8 itself and these will need to be considered when pricing the acquisition of Newco should this acquisition route be followed.

Conclusion

The direct purchase of the trade and assets would allow the Compglo group to benefit from tax relief on

- expenditure of £13.6million in relation to goodwill reducing the future tax bill by approximately £2.72 million at current rates spread over a maximum period of 25 years,
- uplifted capital allowance pool to the current market value of the fixtures, fitting and computer equipment.

However, £4.8million SDLT would be payable. Furthermore the vendor is likely to incur a Corporation Tax liability of £2.72 million on the sale of goodwill. The tax costs make this option unattractive.

Alternatively, a share purchase would cost Compglo £150,000 in Stamp Taxes and the vendor up to £3.4 million in SDLT. Brought forward losses in the company might also be available.

Subject to commercial considerations, if a share acquisition could be delayed until May 2016, this would be the most tax efficient option as the vendor would have no SDLT liability and the overall tax burden would therefore be minimised. However the due diligence work could make this alternative less attractive if risks are identified in which case the hive-down alternative could be more appropriate although this creates a number of tax charges.

3. Jamieson Ltd acquisition

The Jamieson purchase could take the form of either a share or asset purchase. Given the stated requirement for after tax proceeds of £10 million, the respective costs of acquisition from our perspective depend on the taxation suffered by the Jamiesons.

The attached Appendix indicates that we would have to pay £11million for the share capital of the company, assuming that Mr and Mrs Jamieson are able to benefit from Entrepreneurs Relief, or approximately £11.785 million for the trade and assets of the company.

This additional cost would be offset in the future by the benefits arising to Compglo through the purchase of assets. Tax relief would be available on the £3.685 million paid for the goodwill: a potential tax saving £737,000 at current rates, spread over the period of amortisation at 4% per annum.

There will also be an increased base cost for the property which will reduce the level of any gain accruing on a subsequent disposal - potential value at current rates £48,000 (£240,000 @ 20%).

If Compglo acquires the shares of the company, the company will continue to hold assets with their original acquisition cost. The base cost of the shares for Compglo will be the £11m paid for them.

VAT
No VAT would arise in connection with the acquisition of the share capital as the sale of shares is exempt from VAT. There would be no immediate changes to the VAT registration of Jamieson Ltd, although it would be possible for the company to join a group registration with Compglo.

Since Compglo is already VAT registered due to its activities, it is likely that a purchase of the trade and assets would not be a supply of goods provided it also meets the conditions to qualify as a Transfer of a Going Concern (TOGC) on the basis that the whole of the business of the transferor will be transferred as a going concern, the assets will be used by the transferee in the same kind of business as that carried on by the transferor and there is no significant break in trading.

In addition, as the property is more than three years old, its transfer will also be covered by the TOGC rules meaning no additional VAT cost will arise on the transfer.

**Stamp taxes**

On a share acquisition, Stamp Duty will be payable at 0.5% of the purchase consideration i.e. Compglo will be liable to pay £55,000.

On a trade and asset purchase, SDLT will be payable on the transfer of the property giving an additional cost of £72,000 (£1.8 million @ 4%).

There is therefore no significant difference in the stamp taxes payable between the two forms of transaction.

**Conclusion**

In the short term, the cost of the acquisition is likely to be slightly lower if the shares of the company are purchased. Due diligence on a share purchase might, however, reveal tax risks that would point towards an asset purchase being more attractive to Compglo.

**Ethical matters**

Our Operations Manager has noted that Mr and Mrs Jamieson would like an element of the consideration paid to an account in Bermuda.

The contract for the acquisition will show the full consideration and Mr and Mrs Jamieson should be aware that this documentation will be available to HM Revenue & Customs regardless of the basis of the payment.

Our employees are bound by the ethical rules of their professional bodies when considering this request.

Although the guidance on ethical rules provided by the professional bodies is addressed primarily to members in practice, nonetheless the principles will apply as relevant to all members. As a result we should ensure that our actions do not in any way support a loss of revenue to the tax authorities. Whilst the information available at present does not directly indicate any form of evasion we should ensure that any further information relating to the payment proposals be documented and, to the extent there is evidence that this is for tax evasion reasons, we should decline to make the payment in this form. We do not want to undertake actions which would adversely impact upon our reputation were the information to become publicly available nor do we wish to give reason for HMRC to question our integrity.

Nonetheless, whilst acting ethically we should be aware that Mr and Mrs Jamieson’s tax affairs are their personal responsibility. We are not their tax advisers and we are not normally required to disclose anything to other parties beyond the details we will disclose in respect of Compglo’s position.
4. Händler GmbH (‘Händler’)  

The comments below consider tax issues relevant to the acquisition of the share capital as prescribed by the sales memorandum.

Taxation of overseas subsidiaries

The profits of the corporate entities are taxable in each company’s country of residence. In addition the permanent establishment (PE) operations will be taxable in their countries of operation.

Following the acquisition, the Händler sub-group companies will all become subsidiaries of a UK company. Subject to the CFC rules discussed below, no UK tax charge arises on profits earned by the non-UK resident subsidiaries insofar as no PE operations are conducted in the UK. If these profits are subsequently extracted by way of dividend, they would be exempt subject to anti-avoidance rules which could result in tax on the distribution of pre acquisition profits (but only if they derived from transactions designed to achieve a UK tax advantage). No further tax would arise on the extraction of post acquisition profits from the subsidiaries.

UK tax can arise through the application of the Controlled Foreign Company (CFC) rules which are designed to prevent companies from artificially diverting profits away from the UK.

A CFC is a company which is not resident in the UK and is controlled by a UK resident. Acquisition of Händler is likely to mean that control of Händler and all its subsidiaries would be considered to be exercised by Compglo Ltd.

The profits of a CFC can be apportioned to and taxed on the UK parent company if some or all of its profits fall within a gateway subject to exemptions (see below).

The exemptions are as follows:

- **Exempt Period Exemption** - this is a temporary exemption for foreign subsidiaries already carrying on a business coming under UK control which would apply immediately following the acquisition for the first 12 months. This allows time to restructure the operations to avoid a CFC charge. This exemption would apply to Games Developer (Jersey) Ltd provided it meets a CFC exemption following the 12-month period which may not, however, be the case (see below).

- **The Low Profits Exemption** – a de minimis test whereby no CFC charge arises on investment income profits below £50,000. It appears that the activities of Games Developer (Jersey) Ltd will be regarded as giving rise to investment income, and the recent levels of profits are such that this exemption will not apply.

- **The Low Profit Margin Exemption** – applies if the CFC has a profit margin of no more than 10% of its relevant operating expenditure. It is not clear whether or not this would apply to Games Developer (Jersey) Ltd.

- **Excluded Territories Exemption and Tax Exemption** – companies resident in countries on the excluded list are automatically excluded from the CFC legislation. Even if a country is not included in the list of Excluded Territories, an exemption is available if the local tax is at least 75% of the corresponding UK tax. Therefore Händler, the German company, (even if Germany were not already on the Excluded Territories list), will be exempted from a CFC charge under the tax rate provision, but this will not apply to Games Developer (Jersey) Ltd (the Jersey company) with a nil rate of tax.

As none of the exemptions are likely to apply to Games Developer (Jersey) Ltd, we will have to consider if any of the future profits pass through any of the gateways defined in the legislation. Only profits passing through one of the gateways are liable to the CFC charge.
Four of the five gateways (non trading finance profits, trading finance profits, captive insurance business and solo consolidation for banking subsidiaries) are not applicable to the activities carried on by Games Developer (Jersey) Ltd and it is therefore only necessary to consider profits attributable to UK activities.

This test is designed to identify profits where the CFC is reliant on the UK to take on and manage its risks in a commercially effective way. There are a number of automatic exclusions such as a motive test, and an exclusion if there are no UK managed assets. Further details of the activities of Jersey should be considered focusing on the level of the management of the intellectual property which occurs in the UK. If the profits of the operations are deemed to pass through the gateway they will be liable to tax in the UK and therefore consideration should be given to simplifying the group structure and undertaking the activity of the Jersey company in one of the UK companies. This may present an opportunity to benefit from the patent box regime – see below.

**Patent Box**

The patent box regime allows companies which own patents to elect for the profits relating to the patents to be separately identified and to pay tax at 10% on defined profits from patent activity. However it is likely that companies will need to be within the scheme by June 2016 and benefits will cease from June 2021. When considering any cost benefit analysis we will need to work within this timeframe and if the companies are not in the existing scheme by them, how they might take advantage of any new scheme that may be introduced.

We would need to review the activities undertaken by each company and consider the effect of transferring the management of the patent back to the UK. To qualify for the regime, the UK company would be required to hold qualifying IP rights or an exclusive licence in respect of any qualifying IP rights and, being a member of a group, meet the active ownership condition.

If the activities of Jersey were therefore transferred to a UK resident company, the tax charge arising on the associated profits could be subject to a 10% rate of tax by 2017 when the regime is fully introduced.

If the necessary changes to benefit from the scheme are considered commercially sensible we should ensure these are adopted as soon as possible to allow access to the reduced rate and to maximise the benefit of this before the patent box is scrapped or amended.

**Research and Development Tax Relief**

UK companies can claim additional relief in respect of qualifying expenditure related to their trade being expenditure developing or improving the science or technology of their products, including appropriate staff costs, consumables, utilities and in certain cases subcontracted activities. It is likely that significant costs of this nature will arise in the development activity currently undertaken by Games Developer (UK) Ltd and the tax payable by the group will therefore be minimised if we can ensure that all applicable costs are identified and included within a claim.

The level of the deduction and the form of the relief is dependent upon the size of the company. If the acquisition proceeds the group employees will exceed 500 and as a result the company will not therefore be eligible for small or medium sized enterprise (SME) reliefs.

As a member of a large group, the company can take an additional 30% deduction in respect of eligible spend reducing the taxable profits. Alternatively, on making an irreversible election a company can claim a 10% credit. This is paid to the company first by reduction of tax liabilities or amounts due to HMRC, then as a cash payment. The amount of the credit is recorded ‘above the line’ and included in arriving at pre tax profits.
We should therefore review the nature and level of the expenditure and going forward consider the most appropriate company to undertake any eligible activity.

**Taxation of branch operations**

As a general rule, profits are first taxable in the territory where they arise, and secondly in the territory of residence of the entity which owns the trading activity. Tax suffered in the first territory is generally relieved against tax in the second territory under double tax treaties between the counties in question.

An election is available in the UK, on a company-by-company basis, whereby overseas permanent establishments (PEs), can be elected out of UK taxation. Clearly this is beneficial only where the overseas rate is lower than the UK rate and where the overseas PE is profitable.

Currently, it is likely that the Swedish profits are being taxed at German rates and the French losses are being relieved at German rates. There would therefore appear to be

- an advantage, in transferring the Swedish branch to a UK or Swedish company, subject to any additional tax arising in Germany on a transfer. Swedish profits would then be subject to a maximum tax rate of 22%,
- no advantage in transferring the French branch to the UK, subject to ensuring that we optimise relief for the French losses. Once it becomes profitable, the French branch will be subject to French tax at 33.1%.

The other option would be to incorporate the French or Swedish operations. As with the branch exemption, this is unlikely to be beneficial if the branches are making losses as the current structure allows the corporate entity to benefit from these losses which could otherwise be stranded.
Appendix – Jamieson Ltd – calculation of consideration required so that vendors receive £10 million

Share purchase

Mr and Mrs Jamieson would be liable to tax on chargeable gains arising from the disposal of their shares. They are likely to meet the conditions for entrepreneurs’ relief because for one year prior to the disposal of their shares:

- The company is their personal trading company as they each hold 50% of the share capital,
- They have held their shares in and have worked for the company (in fact that have done so for 10 years).

As a result, the gains arising on the sale of the shares would be taxed at 10% up to the lifetime limit of £10 million each.

Subject to the relief being available (and not having been used previously), total consideration of £11 million would result in a total gain of £10 million (original cost £1 million) (one-half of which will be taxed on each of the parties). Tax at 10% would total £1 million (disregarding the insignificant impact of their annual exemptions), resulting in a net receipt of £10 million as required.

Asset purchase

The total consideration would be payable to Jamieson Ltd and Mr and Mrs Jamieson would then have to extract the cash from the company. A liquidation of Jamieson Ltd would enable them to achieve a 10% tax rate due to the availability of Entrepreneurs’ Relief on the winding up of a personal company (provided this takes place within 3 years of it ceasing to trade when we acquire its trade and assets).

This would therefore require funds available in the company of £11 million as above.

Assuming that the identified assets are sold to us at their market value, cash would be realised as follows:

<table>
<thead>
<tr>
<th>Net current assets</th>
<th>£’000</th>
<th>No tax anticipated as market value comparable to cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant and machinery</td>
<td>500</td>
<td>No significant balancing allowance or charge would arise providing that market value is comparable to tax written down value – this would need confirming</td>
</tr>
<tr>
<td>Property</td>
<td>1,752</td>
<td>Indexed cost £1.56m (1.2m x 1.3). Gain therefore £240,000, tax at 20% £48,000. Net proceeds 1.8m less tax £48,000</td>
</tr>
<tr>
<td>Total</td>
<td>8,052</td>
<td></td>
</tr>
</tbody>
</table>

The balance of consideration would be for goodwill. As the company has generated the intangible assets since it was set up in May 2005, and thus has no base cost, that consideration would be taxed in full as part of the Jamieson Ltd’s trading profit. The cash available therefore will be 80% of the consideration paid, meaning that Compglo would be required to pay £3,685,000 (£11 million less £8.052 million (above) = £2.948 million grossed up for 20% tax) in order to realise sufficient net consideration for Mr and Mrs Jamieson. Thus the total consideration payable by Compglo is:

<table>
<thead>
<tr>
<th>Total consideration</th>
<th>£’000</th>
<th>Tax</th>
<th>After tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intangibles</td>
<td>3.685</td>
<td>0.737</td>
<td>2.948</td>
</tr>
<tr>
<td>Property</td>
<td>1.8</td>
<td>0.048</td>
<td>1.752</td>
</tr>
<tr>
<td>Plant</td>
<td>0.5</td>
<td>0</td>
<td>0.5</td>
</tr>
<tr>
<td>Net current assets</td>
<td>5.8</td>
<td>0</td>
<td>5.8</td>
</tr>
<tr>
<td>Total</td>
<td>11.785</td>
<td>0.785</td>
<td>11.0</td>
</tr>
</tbody>
</table>
# CIOT MARKING GUIDE

<table>
<thead>
<tr>
<th>Requirement 1</th>
<th>Marks</th>
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<tr>
<td>Identify acquisition options</td>
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<td>Sub-total</td>
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## Innov8 – share purchase
- Tax basis/ SSE: 1
- Cost £30m and loan repayment: 1
- CAs and losses: 1
- Unless group relieved – check in DD: 1
- MCINOCOT: 1
- Thin cap issue: 1.5
- Future refinancing and suggested basis: 1.5
- VAT – exempt: 0.5
- Tamp taxes – SD £150k: 1
- SDLT potential clawback: 1
- Vendor – possible SSE, Degrouping and impact: 1.5

## Innov8 – asset purchase
- Allocation of cost: 1
- Goodwill £13.6m: 1
- Relief worth £2.72m, accounts or 4%: 1
- CAS – property based on election: 1
- Other Cas: 1
- AIA: 1
- VAT – TOGC: 3
- Property - opt to tax: 1
- Capital goods scheme: 1
- SDLT – 4% £4.884m: 2
- VAT inclusive: 1
- Vendor - asset sale – CGT and taxable credit - losses: 2
- Distribution centre calc: 1
- Properties calc: 2

## Innov8 - conclusion
- Discuss hivedown: 1
- Conclusion: 1

## Total for Requirement 1
- Sub-total: 2
- Total: 33

## Requirement 2

### Jamieson – share purchase
- Entrepreneurs relief inc conditions and lifetime limit: 1.5
- Calculate consideration £11m: 1
- Stamp duty £55k: 1
- VAT exempt: 0.5
- Historical liabilities hence DD required: 1

### Jamieson – asset purchase
- Double taxation due to extraction of funds: 1
- Calculate goodwill value £3.678m: 3
- Tax reliefs: 1
- VAT – TOGC: 1
- SDLT £72k: 1

## Sub-total
- Total: 7
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<th>Jamieson – conclusion</th>
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<td>• Cashflow benefit on share acq, but potential liabilities</td>
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<tr>
<th>Ethics</th>
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<tbody>
<tr>
<td>• Issue re payment to Bermuda</td>
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<tr>
<td>• Reason? Further info</td>
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<td>• Rules of professional body apply even in industry</td>
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<td>• Protect reputation Sensible conclusion</td>
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| Total for Requirement 2 | 18 |

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<tr>
<td><strong>Taxation of overseas subsidiary</strong></td>
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<tr>
<td>• No UK tax on profits or dividends</td>
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<td>• CFC rules</td>
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<td>• Exemptions and application</td>
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<td>• Gateways – need more info</td>
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<td>• Possibility of restructure</td>
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<td>• Double taxation with DTR</td>
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<td>• Branch exemption</td>
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<td>• Consider benefit – Swedish profits</td>
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<td>• Losses get more relief at higher German rate</td>
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<td>• Possibility of incorporation, but not beneficial if losses</td>
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<td>• Patent box rules for UK companies – consider bringing activities onshore</td>
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<td>• Tax rate and operation</td>
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<td>• transition</td>
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<td>• RDEC</td>
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| Total for requirement 3 | 27 |

| Total requirements 1 2 & 3 | 78 |

| Presentation and higher skills | 22 |

| Grand Total | 100 |