Acquisition financing in Europe

After the crisis, a new tax landscape
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Acquisition financing in Europe

Chair

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Programme

— General acquisition finance considerations, including points of interest per country:
  - Germany
  - France
  - Italy
  - United Kingdom
  - Spain
  - Belgium

— Case study

General Acquisition Finance Considerations
1. General Tax Environment

Country	Effective CIT rate	NOL carried forward	Impact of change of control / Loss of NOL	Domestic tax grouping	Ownership percentage
Belgium	33.99%	No time limit	Change of control (50% of the share-capital and/or a majority of the board members) without legitimate economical or financial needs	No	N/A
France	34.43%	No time limit	Loss of NOLs only in the event of a deep change in the activity	Yes	95%
Germany	30-33%	No time limit	Change of ownership of >25% and ≤ 50% → partial cancellation Change of ownership > 50% → full cancellation	Yes	>50%
Hungary	10%-19%	No time limit	No	No	N/A
Italy	27.5 + 3.9%	5 years	Change of control and change of activity	Yes	>50%
Poland	19%	5 years	No	Yes	95%

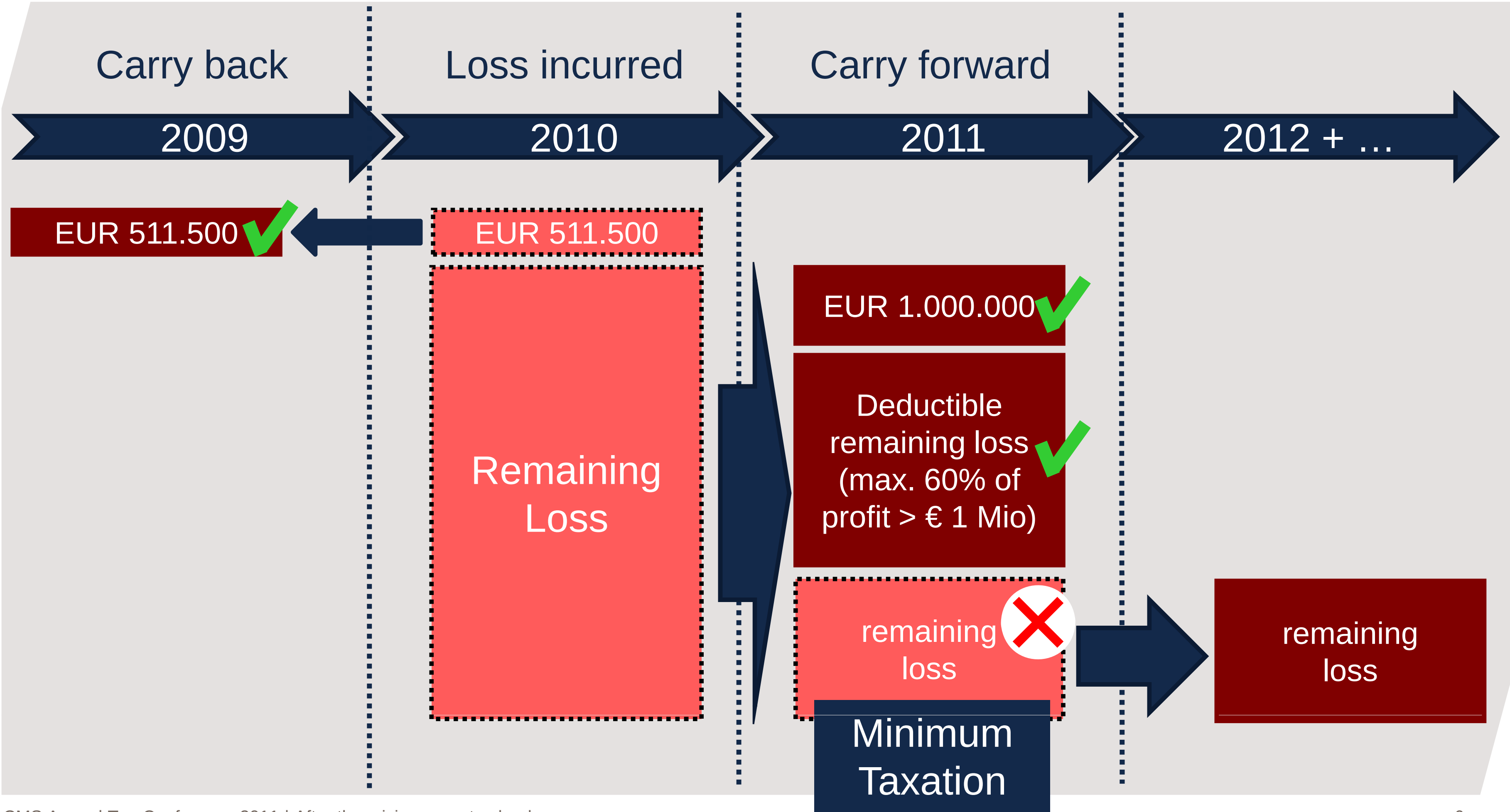
General Acquisition Finance Considerations

1. General Tax Environment (cont'd)

Country	Effective CIT rate	NOL carried forward	Impact of change of control / Loss of NOL	Domestic tax grouping	Ownership percentage
Russia	20%	10 years	No	No	N/A
Spain	30%	15 years	Change of control where the sold company has not developed any economic activity prior to the change	Yes	75%
UK	21-28%	No time limit	Change of control, and major change in the nature or conduct of the trade	Yes	75%

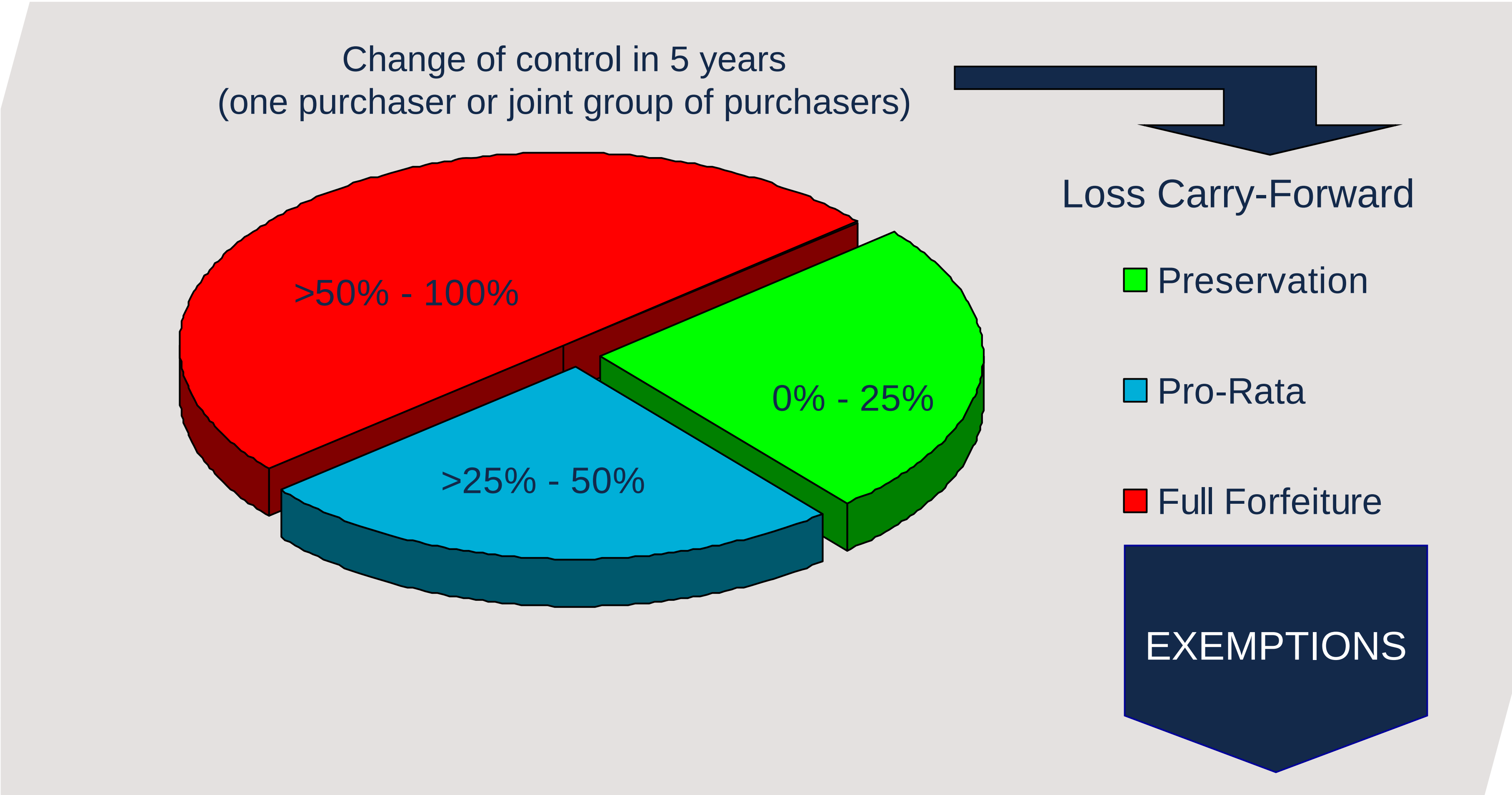
Points of interest per country: ***Germany***

Use of Losses under German Tax Law: Loss Carry-Back/Forward



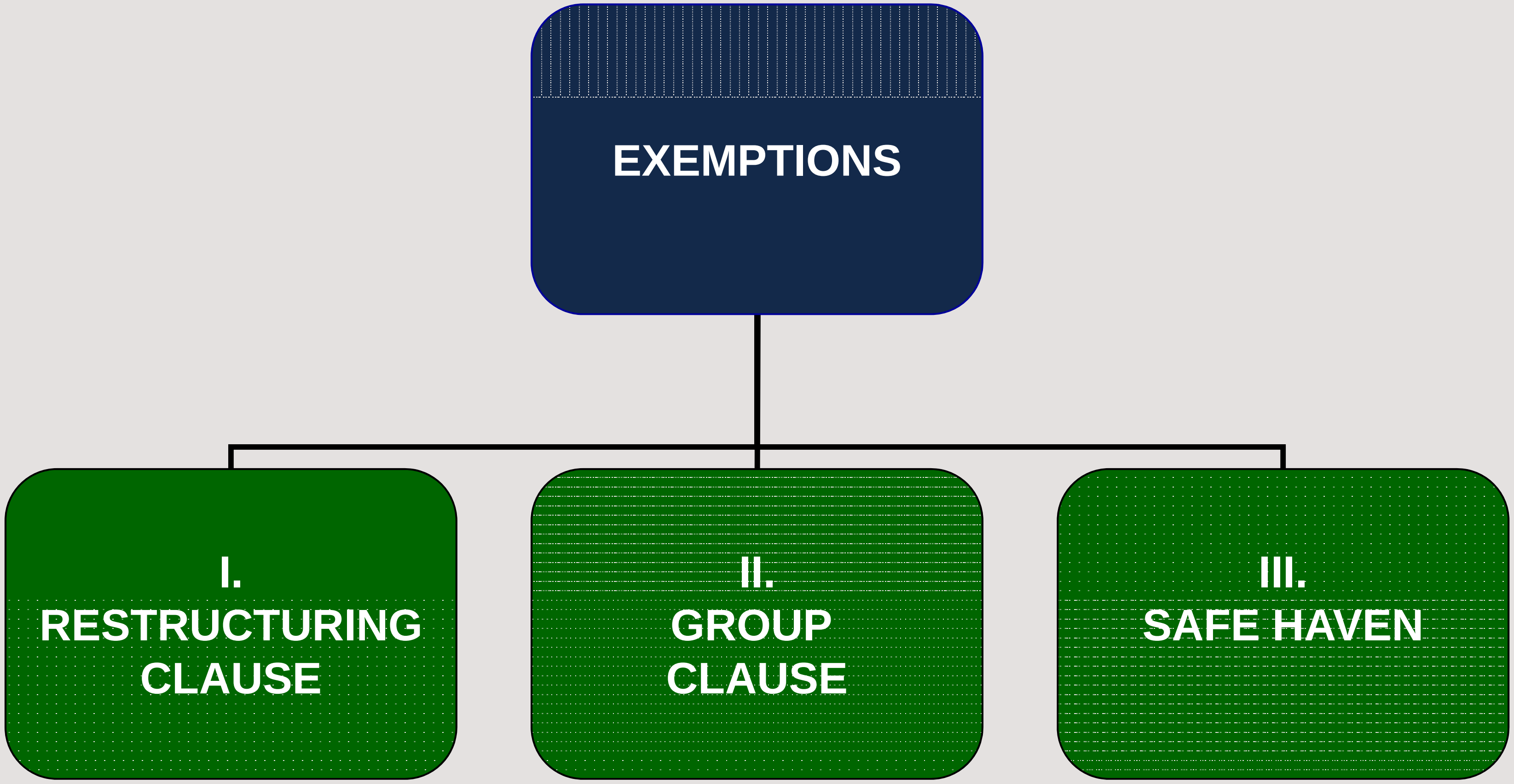
Points of interest per country: ***Germany***

Use of Losses under German Tax Law: Forfeiture of Loss Carry-Forward



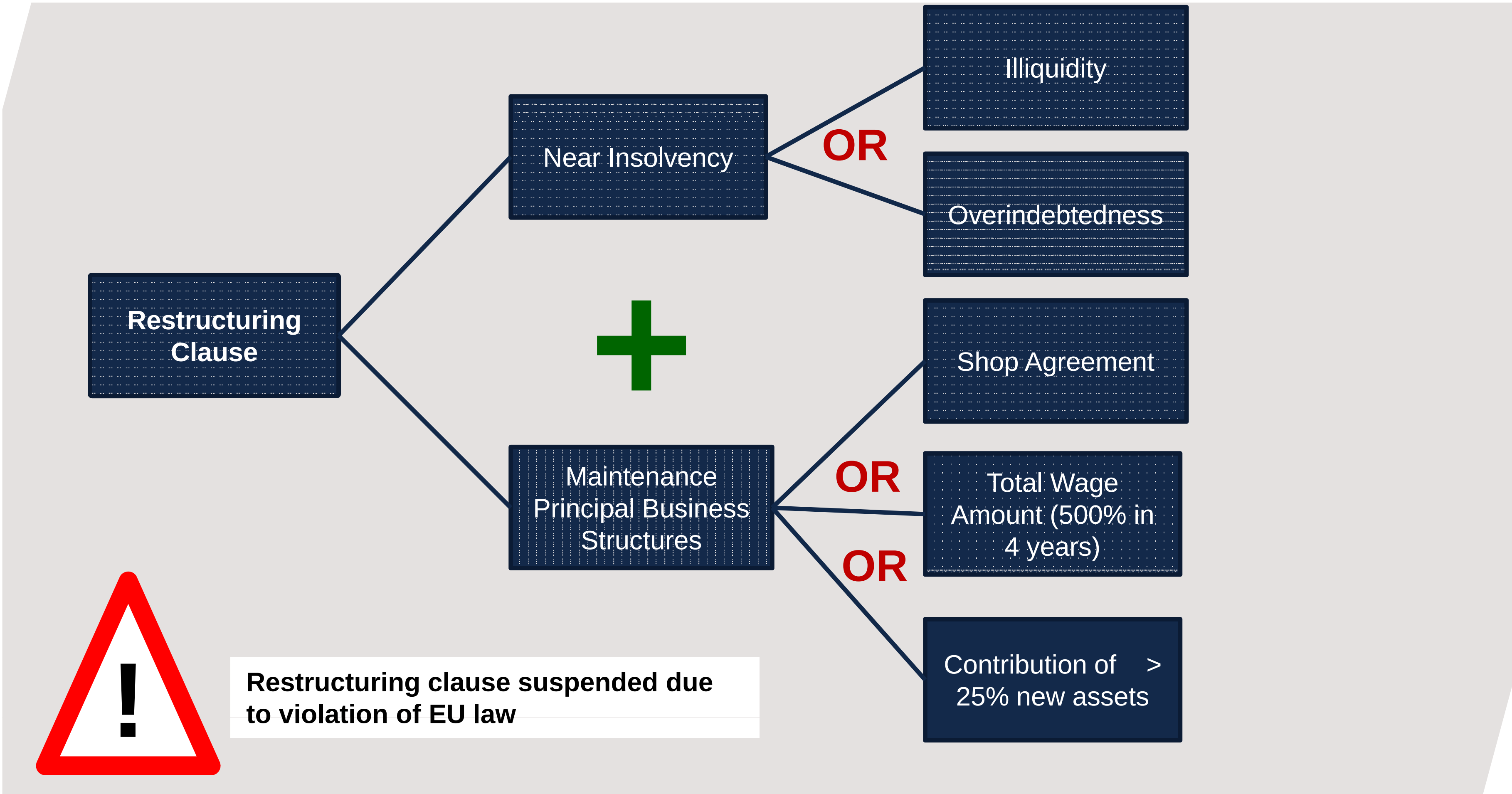
Points of interest per country: ***Germany***

Use of Losses under German Tax Law: Forfeiture - Exemptions



Points of interest per country: ***Germany***

Use of Losses under German Tax Law: Forfeiture – Restructuring Clause



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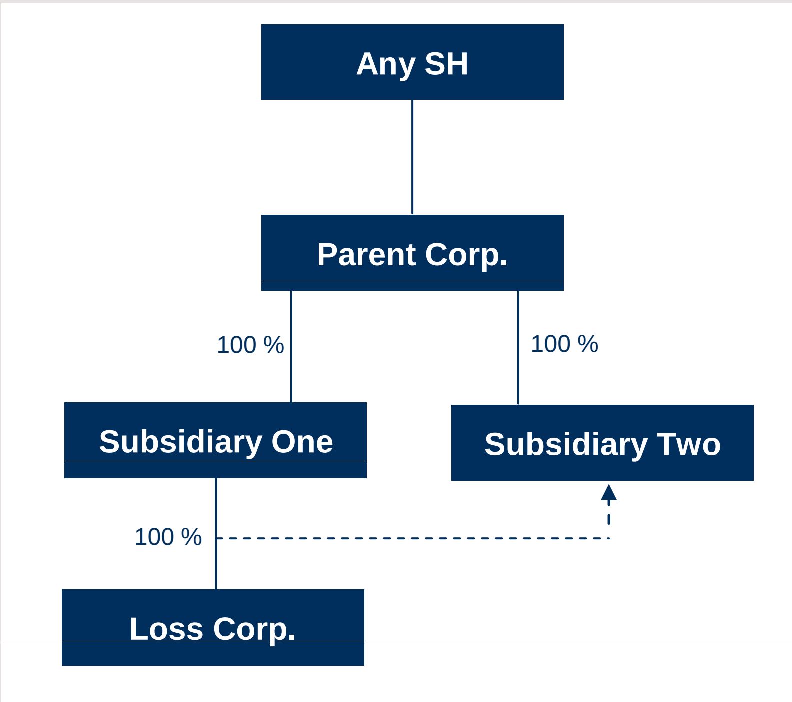
Points of interest per country: ***Germany***

Use of Losses under German Tax Law: Forfeiture – Group Clause I

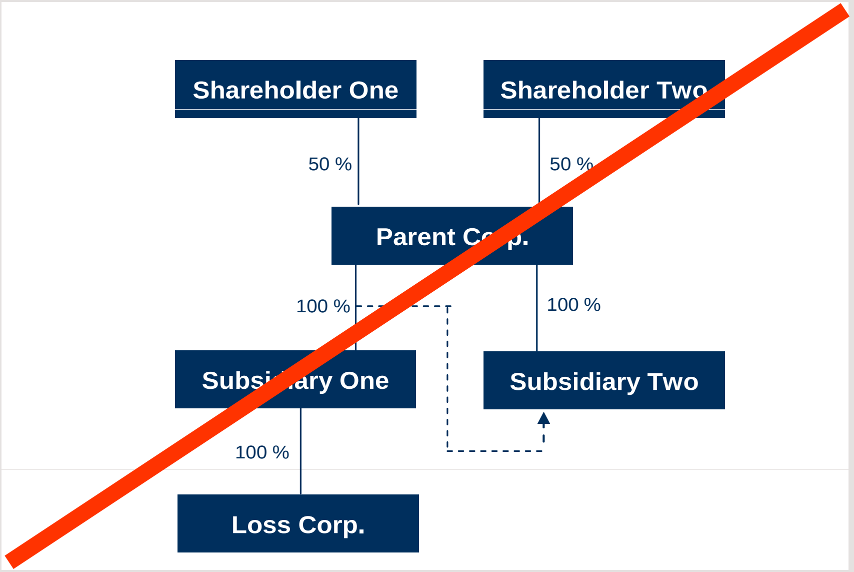
"… all equity/voting rights of transferring entity and receiving entity are (in)directly held by **<u>the same</u>** shareholder."

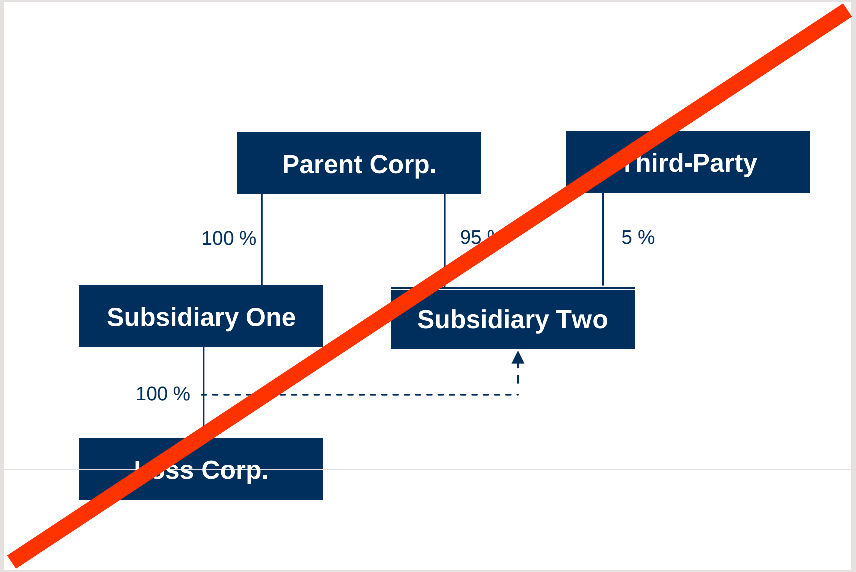


Shareholder Transferring Entity:
Parent Corporation
=
Parent Corporation
Shareholder Receiving Entity

Points of interest per country: ***Germany***

Use of Losses under German Tax Law: Forfeiture – Group Clause II



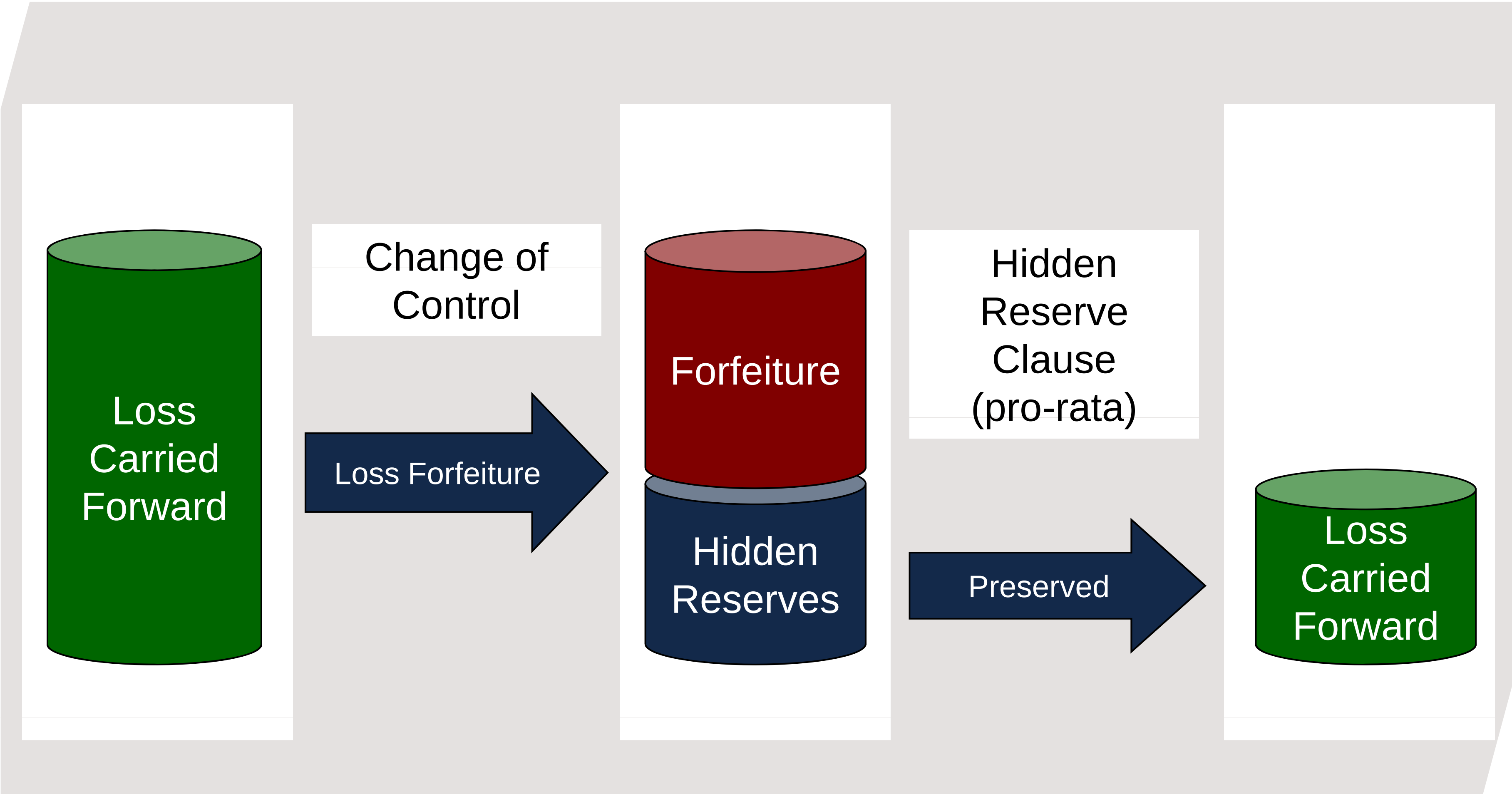


Shareholder Transferring Entity
Shareholder One + Two
≠
Parent Corporation
Shareholder Receiving Entity

Shareholder Transferring Entity
Parent Corporation
≠
Parent Corporation + Third Party
Shareholder Receiving Entity

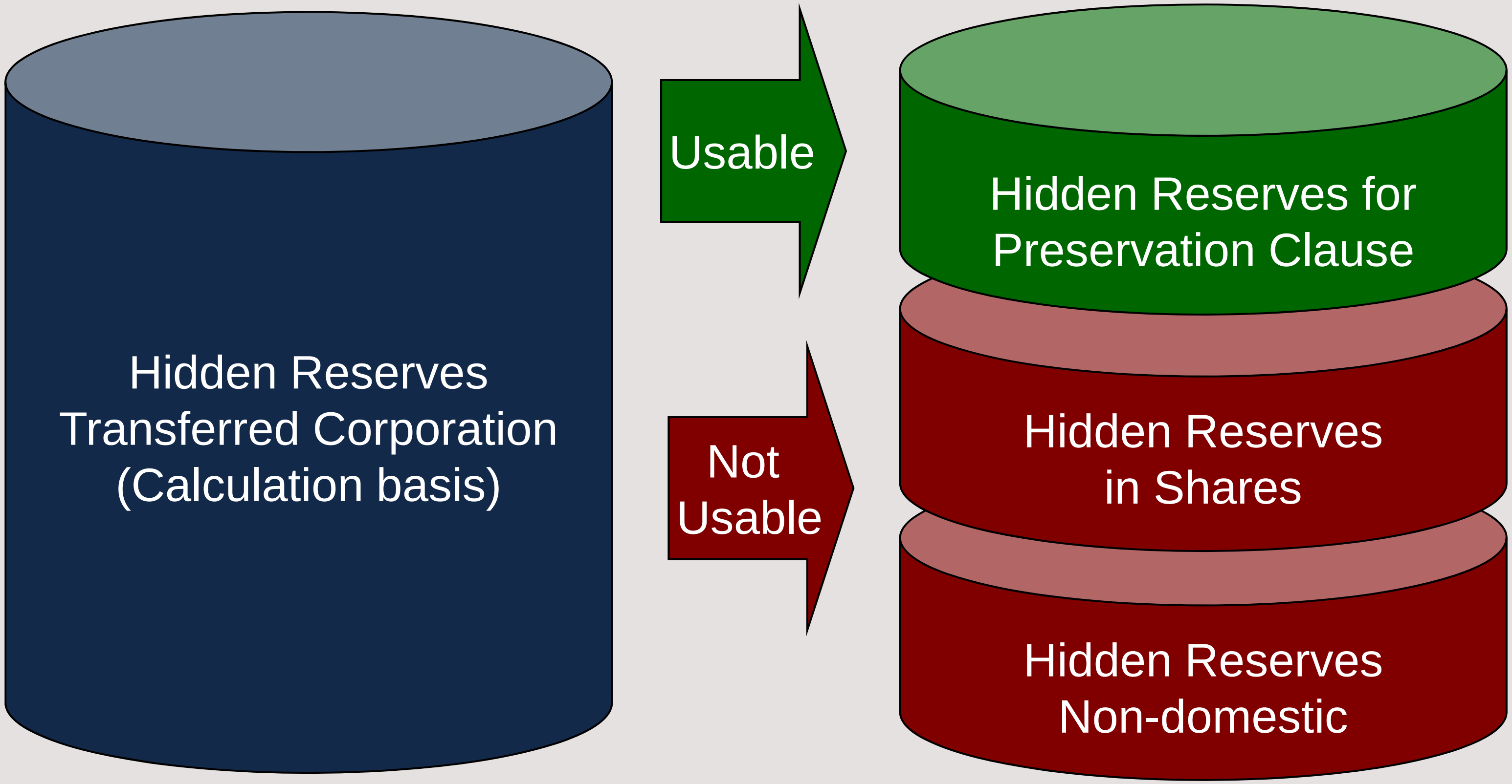
Points of interest per country: ***Germany***

Use of Losses under German Tax Law: Forfeiture – Hidden Reserve I



Points of interest per country: ***Germany***

Use of Losses under German Tax Law: Forfeiture – Hidden Reserve II



General Acquisition Finance Considerations

2. Rules on Interest Deduction

Country	General Rule	Interest Deduction for Acquisition Finance	Thin Cap Rules	Other Limitations
Belgium	Generally deductible, but limited to fair market interest rate	No special provision	1:1 debt/equity ratio: • shareholder restriction 7:1 debt/equity ratio: • tax haven restriction	Possible disallowance if interest is paid to a non-resident and is not subject to taxation in this jurisdiction
France	Generally deductible, but limitations apply to loans granted by related entities (which include interest paid to third party but upon a loan secured by a related party)	General rules apply. Limitations also apply to certain intra-group acquisitions of shares (anti-abuse rules applicable in fiscal unities; "*Amendement Charasse*")	Disallowance for interest expenses exceeding the following limitations: • loans granted by related parties exceed 1.5 times the net equity of the company • 25% of adjusted net operating income • interest income received from related entities	None. Exceptions and safe haven tests are however available.
Germany	Generally deductible	No special provision	No thin cap rule, but arm's length interest rate required for related parties	Interest barrier rule • net interest expenses deduction limited to 30% EBITDA • exemptions: (a) threshold, (b) group clause, (c) escape clause

General Acquisition Finance Considerations

2. Rules on Interest Deduction (cont'd)

Country	General Rule	Interest Deduction for Acquisition Finance	Thin Cap Rules	Other Limitations
Hungary	Generally deductible	Interest allocated to fixed assets increases depreciation volume	Disallowance for interest expenses if debt exceeds 3 times equity of company	No specific anti-abuse rule
Italy	Generally deductible	No special provision	No thin cap rule	Interest barrier rule • net interest expenses deduction limited to 30% EBITDA
Poland	Generally deductible	Interest allocated to fixed assets increases depreciation volume	Disallowance for interest paid to a qualifying lender (24% shareholding) if and to the extent that qualifying loan exceeds 3 times the paid-up share capital	No specific anti-abuse rule
Russia	Generally deductible	No special provision	Disallowance for interest paid to a qualifying lender (foreign company owning directly or indirectly more than 20% shareholding) or guaranteed by such lender if and to the extent that qualifying loan exceeds 3 times the own capital (~net assets) of the company	The interest rate can not deviate for more than 20% from the rate on comparable loans

General Acquisition Finance Considerations

2. Rules on Interest Deduction (cont'd)

Country	General Rule	Interest Deduction for Acquisition Finance	Thin Cap Rules	Other Limitations
Spain	Generally deductible	Intra-group acquisition: • acquisition must be carried out due to very strong commercial reasons, otherwise interest deduction disallowed Non intra-group acquisition: • interest rate for debt used for an acquisition must be at arm's length	If lender is as related party non EU resident and the debt/equity ratio exceeds 3:1 the exceeding interest expenses are treated as dividend	Shareholder loans must be at arm's length interest rate
UK	Generally deductible	Interest on acquisition loan (non-trading transaction) is not fully deductible but offsetable against current profit of the company or the group, offsetable against previous non-trading income and carried forward	• Interest paid to a related party is not allowable unless the granting of the loan is at arm's length. • Historically a debt/equity ratio of 1:1 and an earnings / interest cover of 3:1 were accepted but nowadays HMRC has adapted a case by case approach	Worldwide debt cap rules • In a large group the interest deduction is restricted if the UK net debt of the whole group exceeds 75% of the worldwide gross debt of the group

Points of interest per country: ***France***

Thin capitalization rules (cont'd)

2. Limitation on interest expenses deductibility for loans granted by related parties

2.2. Limitations set out by article 212 FTC

The provisions of article 212 FTC apply to interest expenses accrued by a French company on borrowings from related companies in the meaning of article 39-12 FTC, i.e. (i) from a shareholder which holds directly or indirectly the majority of the share capital of the borrower, (ii) or from companies of which the majority of the share capital is directly or indirectly held by the same ultimate shareholder as the borrower, (iii) or *de facto* managed by the same ultimate entity.

Under the Finance Bill for FY 2011 (applicable to fiscal years ending as from 31 December 2010), bank debt whose reimbursement is secured by a related entity will also fall into the scope of article 212 FTC.

Certain exceptions have however be set out, in respect of funds lent:

- in relation to bonds issued within the context of public offerings
- up to the amount whose reimbursement is exclusively secured by a pledge on the shares of the borrowing entity (or receivables of the latter) or on the shares of the entity holding the shares in the borrowing entity provided that the holder of said shares and the borrowing entity are part of a same fiscal unity
- subsequently to the reimbursement of a preexisting debt, ***as a condition set out within the context of a change of control of the borrowing entity***
- in relation to loans concluded before 1st January 2011, ***within the context of the acquisition of shares or within the context of the refinancing of the latter operation*** (e.g., notably LBOs).

Points of interest per country: ***Italy***

Interest deduction for holding companies (cont'd)

— Basic rule (for companies different from banks, insurance companies and other financial institutions)

- Interest expenses are deductible for an amount corresponding to:
  — Interest income accrued in the relevant FY (Step 1), and
  — 30% of the EBITDA generated by the taxpayer in the relevant FY (Step 2).
- This rule applies to both related party debts and third party debts
- A carry forward mechanism (with no time limitation) provides that non-deductible interest in a given FY may be deducted against future capacity of the 30% EBITDA
- Unused EBITDA excess over interest expenses of one FY can be carried forward to increase EBITDA capacity of future FYs

Points of interest per country: ***Italy***

Interest deduction for holding companies

EXAMPLE 1 – Computation of non-deductible interest expenses	FY X
a) Value of production	100
b) Costs of production	50
c) Depreciations	10
d) Financial lease charges	10
e) EBITDA (a – b + c + d)	70
f) 30% of EBITDA	21
g) Interest expenses	50
h) Interest income	10
i) Net Interest Expenses (g – h)	40
Step 1) Interest expenses deductible within the limit of interest income	10
Step 2) Interest expenses deductible within 30% EBITDA capacity	21
l) Non-deductible interest expenses	19

Points of interest per country: ***Italy***

Interest deduction for holding companies (cont'd)

— Specific features for holding companies

- Holding companies typically lack of eligible EBITDA since their revenues are generally represented by dividends, interest and capital gains
- Interest expenses are therefore deductible only within the limit of interest income accrued in the relevant FY

— Remedies

- Option for tax consolidation
- Virtual tax consolidation
- Quick merger

Points of interest per country: ***Italy***

Interest deduction for holding companies (cont'd)

— Option for tax consolidation

- Non-deductible interest expenses pertaining to a consolidated entity (e.g. holding company) can be offset, and then deducted on a consolidated tax basis, against any excess of 30% EBITDA realized by other entities pertaining to the tax group

- Timing features !

Points of interest per country: ***Italy***

Interest deduction for holding companies (cont'd)

EXAMPLE 2 – Deduction of interest expenses within the tax group						
FY X	Interest expenses	Interest income	Net Interest Expenses (A)	30% EBITDA (B)	Non deductible NIE (C=A-B)	30% EBITDA excess (D=B-A)
Holding Company	12.000	4.200	7.800	0	7.800	Zero
Company A	16.700	Zero	16.700	5.500	11.200	Zero
Company B	22.300	8.950	13.350	25.350	Zero	12.000
TOTAL					18.000	12.000*

* Interest expenses deductible from the consolidated taxable income

Points of interest per country: ***Italy***

Interest deduction for holding companies (cont'd)

— Virtual tax consolidation

- For the computation of deductible interest expenses the taxpayer is entitled to consider any excess of 30% EBITDA pertaining to its foreign subsidiaries, provided they satisfy the conditions to elect for the domestic tax consolidation regime

— Quick merger

- Non-deductible interest expenses of the companies involved in a merger may be offset against future capacity of the 30% EBITDA of the company resulting by the merger. However, interest expenses can be carried forward within the same limitations applicable, in case of merger, to tax losses

General Acquisition Finance Considerations

3. Interest Deduction after Restructurings

Country	Tax Group	Upstream Merger	Downstream Merger
Belgium	Not applicable	No restriction of interest deductibility	Interest on loan for acquisition of absorbing company might be challenged by tax authorities
France	General rules apply, however additional limitation for interest deduction may apply in the event of certain intragroup acquisition of shares (“*Amendement Charasse*”)	General rules apply. A specific limitation on interest deduction may apply in the event of so-called “*quick merger*”	General rules apply. A specific limitation on interest deduction may apply in the event of so-called “*quick merger*”
Germany	Interest deduction subject to general rules, i.e. interest barrier rule	Interest deduction subject to general rules, i.e. interest barrier rule	Interest deduction subject to general rules, i.e. interest barrier rule
Hungary	Not applicable	General rules apply	General rules apply
Italy	General rules apply, however special group relief for interest barrier rule	General rules apply	General rules apply
Poland	Interest deduction subject to general rules, i.e. interest barrier rule	Interest deduction subject to general rules, i.e. interest barrier rule	Interest deduction subject to general rules, i.e. interest barrier rule

General Acquisition Finance Considerations

3. Interest Deduction after Restructurings (cont'd)

Country	Tax Group	Upstream Merger	Downstream Merger
Russia	Not applicable	General rules apply	General rules apply
Spain	General rules apply	General rules apply	General rules apply
UK	General rules apply, however at level of Holdco, the provision regarding so-called non-trading transactions might affect full deductibility of interest	Mergers are not favourable under UK law	Mergers are not favourable under UK law

Points of interest per country: ***UK***

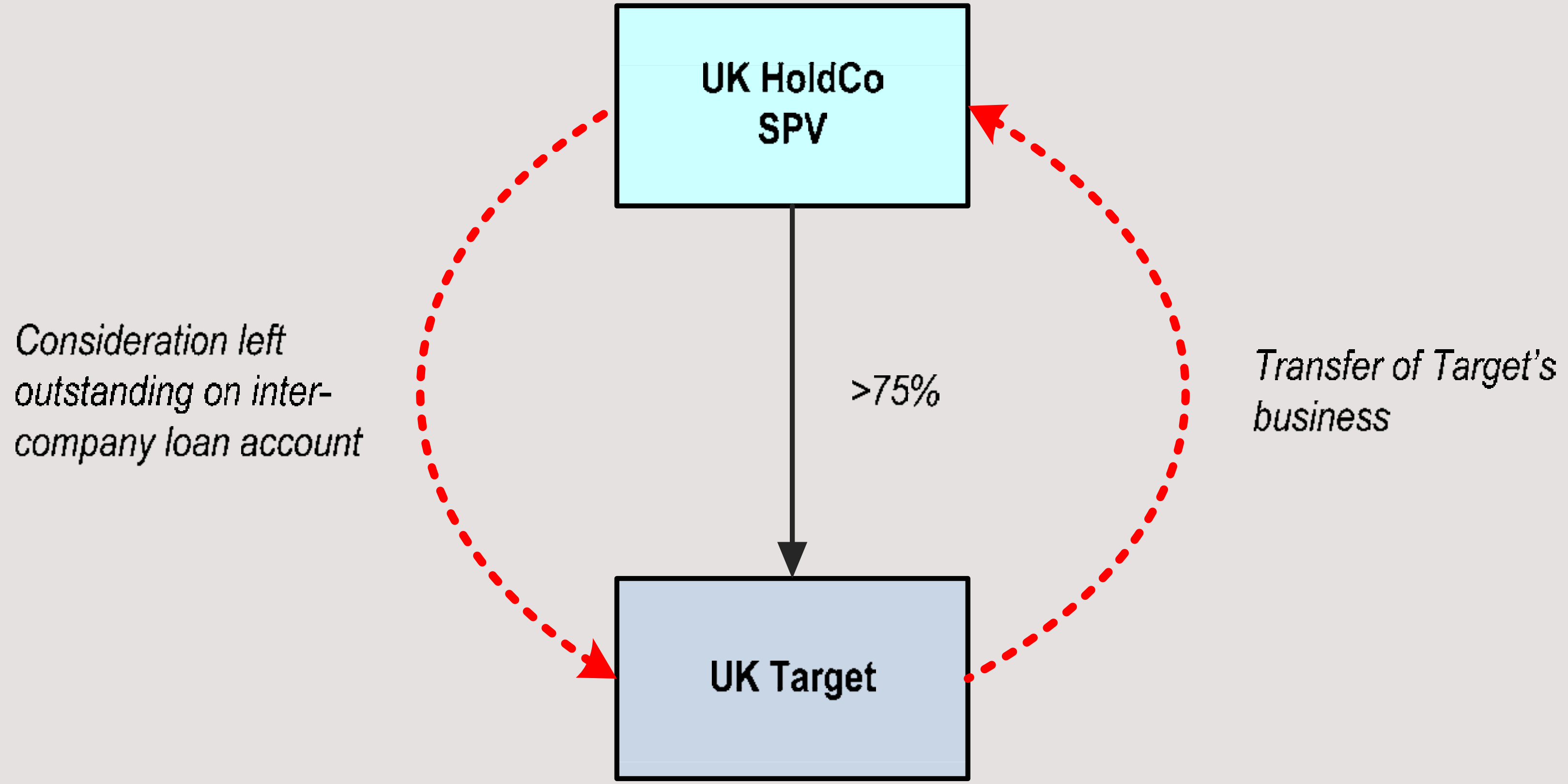
The problem on acquisition of Target

— Two UK risks on acquisition and retention in existence of Target are of current relevance:

- If insufficient profits in Target to group relieve interest deduction (for payments to bank/connected parties) in UK Holdco SPV then such excess interest only available to carry forward and set off against future non-trading income and capital gains in UK Holdco SPV. This issue is particularly relevant now UK has tax exemption on sale of shares in trading subsidiaries (SSE) i.e. no taxable profit on exit against which to set excess interest
- If Target has carry forward trading losses, a change in the nature of or the way the trade of Target is carried on post-acquisition (e.g. in order to try to turn the business around) can forfeit the benefit of the losses

Points of interest per country: ***UK***

The solution: hive-up mechanism



Points of interest per country: ***UK***

The hive-up mechanism

— Tax neutral transfer of trade from Target up to HoldCo

- CGT, SDLT/SDRT and VAT group reliefs
- Election for stock and other trading assets to be transferred at a tax-neutral price

— Target's losses

- Target's entitlement to capital allowances and carried forward trading losses should be preserved in HoldCo even if the trade of Target is altered after hive up into UK Holdco SPV
- Capital losses remain in Target

— Interest expenses on operational loan

- Interest will continue to be off settable against trading profits arising from the transferred trade through a debtor novation

Points of interest per country: ***UK***

The hive-up mechanism (cont'd)

— Interest expenses on acquisition loan

- If there is pre-acquisition and pre-funding evidence (e.g. board minutes etc) that UK Holdco SPV is intending to acquire the trade through the mechanism of the acquisition of Target and the hive up, the interest should be viewed as a trading expense for UK Holdco SPV and therefore off settable and carried forward against current and future trading profits once the business has improved

Points of interest per country: ***UK***

The hive-up mechanism (cont'd)

— Timing

- If there are carry forward trading losses in Target, it is inadvisable for the hive-up to be effected as part of HoldCo's acquisition of Target
  - — Risk that HMRC argue that Target did not beneficially own the trade after completion of HoldCo's acquisition of Target
- It is best if the hive-up is deferred until the end of the month of Target's acquisition at the earliest
- However, to maximise the ability to treat interest on the acquisition debt of UK Holdco SPV need to hive up asap

Points of interest per country: ***UK***

The hive-up mechanism (cont'd)

— Why not liquidate Target?

- Avoidance of CGT issue on Target's historic capital assets thanks to the hive-up prior to the liquidation while tax group still exists
- If Target's shares increase in value after acquisition, there is a 12-month-holding requirement for the substantial shareholding exemption to apply
- More common alternative: Target is left dormant post hive-up and then eventually struck off

Points of interest per country: ***Spain***

Anti-abuse "Abusive" administrative practice

— According to Spanish law, deductibility of interest expenditure in Spain is subject to the following conditions:

- Record of the expense in the accounts of borrower
- Thin capitalization rules, where applicable
- Arm's length rules

related party transactions

— There is no specific anti-abuse provision in the environment of acquisition financing

— The wording of the applicable law is very clear and does not need further interpretation

Points of interest per country: ***Spain***

Anti-abuse "Abusive" administrative practice (cont'd)

— However, the Spanish tax authorities ("STA") deny, as a rule, the deductibility of interest expenditure for intra-group acquisitions when

A Spanish entity funded with debt acquires a stake in a foreign entity, especially (but not necessarily) if such stake was previously held by another group company.

— This type of internal group's reorganizations, not well regarded by the STA, has been frequent in the past years due to:

- Former Spanish provision entailing the depreciation of financing goodwill (now abolished).
- Deductibility of interest expenditure even when the stake acquired qualifies for the "participation exemption regime".

Points of interest per country: ***Spain***

Anti-abuse "Abusive" administrative practice (cont'd)

— The procedural tools for the STA to attack these schemes:

- General anti-abuse provision (a sort of "substance over form" approach)
  - — It requires a special procedure ⟶ difficult for the STA to comply with properly
  - — The outcome is the re-characterization of the interest expenditure as "non deductible" but no penalties can be imposed

- Simulation
  - — Vague and wide concept: difficult to ascertain what falls within its scope
  - — The outcome is also the non deductibility of interest expenditure but here penalties can be imposed
  - — If the amounts at stake are above €120,000 a "simulated" scheme can fall within the scope of tax criminal offences

Points of interest per country: ***Spain***

Anti-abuse "Abusive" administrative practice (cont'd)

— The STA tend to follow the "Simulation" route to challenge "controversial" schemes

- The file is then sent to the Criminal Court where, in case of Sentence, the Judge should rule, not only on the existence of a criminal offence but on the deductibility of the interest expenditure (with no further referral to the Tax Court)
- In order to avoid that a resolution (verdict of non guilty) of a Criminal Court against the STA would prevent the latter from further inquiry, the STA are interpreting that the "Simulation" has different characters in the civil/criminal or in the tax procedure, and accordingly that it is possible to reopen the "Simulation" route in a further administrative stage
- There is a high uncertainty about when and who is going to rule on the substantive and procedural aspects of these cases.

Points of interest per country: ***Spain***

Anti-abuse "Abusive" administrative practice (cont'd)

— In our opinion

- Aggressive schemes could not be attacked through "Simulation" but through the general anti-abuse principle (sort of "Substance over form" approach)
- In order to avoid that a given scheme is challenged under the "Substance over Form" principle, beyond the achievement of a tax benefit, there must be sound economic reasons supporting the scheme*

(*) Based on the belligerent attitude of the STA at all circumstances, we would recommend the existence of valid economic reasons for ALL business operations of tax payers in Spain.

General Acquisition Finance Considerations

4. Other structure opportunities

— Germany: use of partnership structures

— Belgium: notional interest deduction

Points of interest per country: ***Belgium***

Notional Interest deduction

— What is it?

- Innovative measure enabling all companies subject to Belgian corporate tax (or non-resident corporate tax) to deduct from their taxable income a fictitious interest calculated on the basis of their shareholder's equity (net assets)

— Purpose

- <u>Generally:</u> to reduce the tax discrimination between debt financing and equity financing
- <u>More specifically:</u> to "counterbalance" the repeal of the specific tax regime applicable to coordination headquarters

— Effects in Belgium

- General reduction of the effective corporate tax rate and a higher return after tax on investment
- Promotion of capital-intensive investments in Belgium and an incentive for multinationals to allocate such activities as notably intra-group financing, central procurement to a Belgian group entity

Points of interest per country: ***Belgium***

Notional Interest deduction (cont'd)

— How does it work?

- The amount that can be deducted from the taxable base equals the fictitious interest cost on the "adjusted equity capital"
- If the company makes insufficient profit, the deduction can be carried forward during the following seven (financial) years

— Qualifying equity ("adjusted equity capital")?

- Equity capital (which includes capital, share premiums, revaluation gains, reserves, profits/losses) as stated in the company's opening balance-sheet reduced notably by:
  - — The fiscal net value of own shares
  - — The fiscal net value of financial fixed assets qualifying as "participations and other shares" (non-portfolio participations)
  - — The fiscal net value of shares issued by investment companies

Points of interest per country: ***Belgium***

Notional Interest deduction (cont'd)

- The net equity assigned to foreign permanent establishments or real estate property or rights (situated in a country with which Belgium has concluded a tax treaty)
- The net book value of tangible fixed assets, if costs do not unreasonably exceed professional needs
- The book value of tangible fixed assets that are considered as an investment not acquired in order to produce a regular income
- The book value of real estate where its use is granted to directors (their spouses or children)
- Tax-free revaluation gains and capital subsidies

Points of interest per country: ***Belgium***

Notional Interest deduction (cont'd)

— Rate

- It is equal to the annual average of the monthly published interest rates for 10-year linear Belgian government bounds ("OLO's") over the year taken two years before the fiscal year concerned (e.g. the average of the interest rates of 2008 for fiscal year 2010)
- The interest rate for accounting year 2011 will amount to 3.425% (Vs. 3.80% for 2010)
- Small and medium sized companies are entitled to an upgrade of 0.5% (i.e., 3.925% for 2011)
- The interest rate is not allowed to deviate more than 1% from the rate of the previous tax year and must not exceed 6.5%
- If the financial year of a company is shorter or longer than 12 months, the reference notional interest rate is multiplied by the number of days in this financial year and divided by 365

Points of interest per country: ***Belgium***

Notional Interest deduction (cont'd)

— Special features

- If the company makes insufficient profit, the deduction can be carried forward to the following seven years
- The notional interest cannot be deducted from received abnormal or gratuitous benefits
- In case of change in control of a company, the carry-forward privilege is only maintained when such a change can be justified for financial or economic reasons
- No withholding tax on the notional interest deduction
- No acknowledgement (or ruling) is required for the notional interest deduction to apply; the only formal condition to comply with is the completion of an enclosure with the corporate tax return

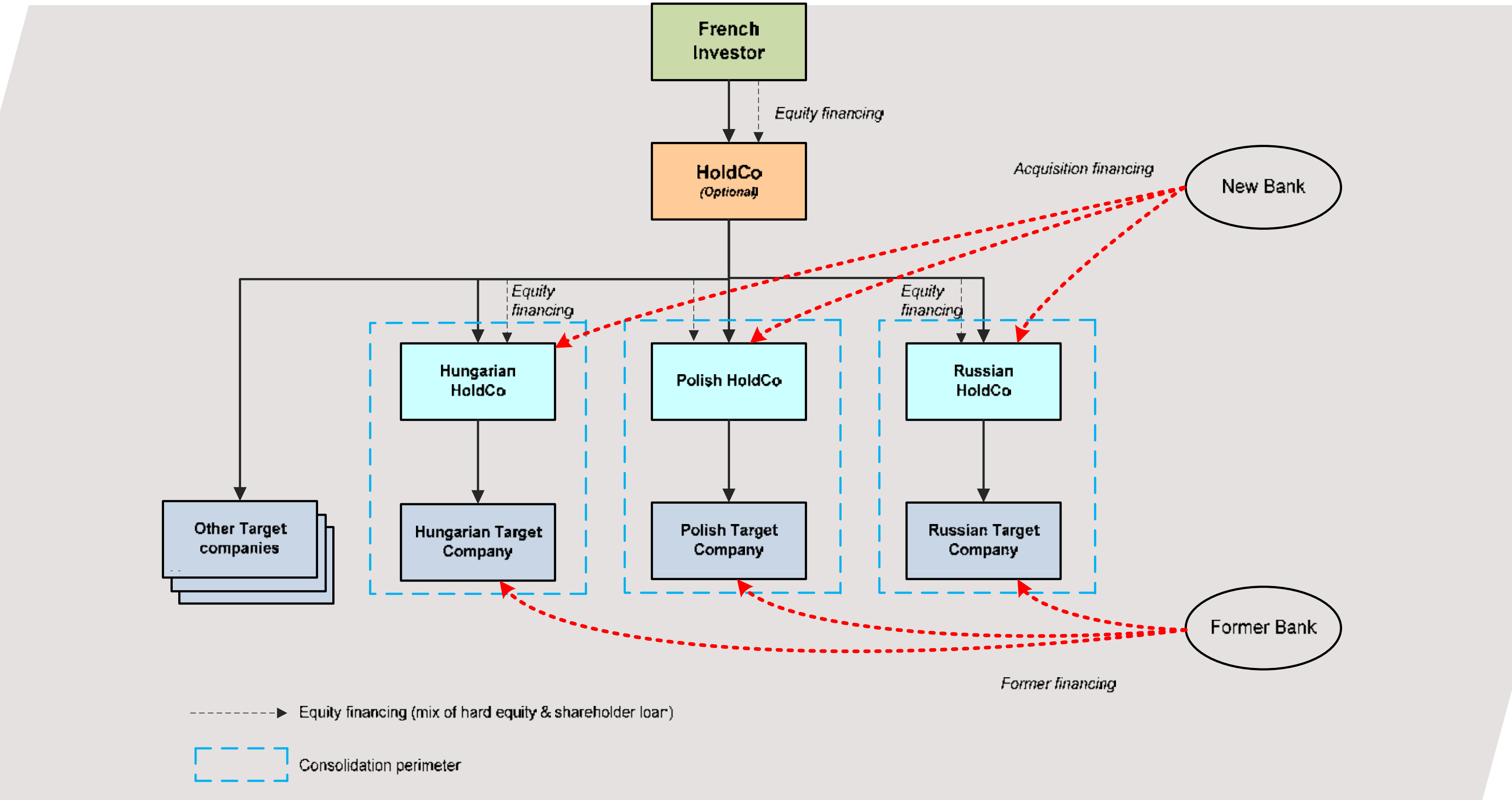
Points of interest per country: ***Belgium***

Notional Interest deduction (cont'd)

— Example

P&L account	Before notional interest deduction	With notional interest deduction
Share capital	10,000	10,000
Profit before tax	500	500
Notional interest deduction (3.8%)	-	- 342.5
Taxable	500	157.5
Corporate tax (33.99%)	169.95	53.5
Effective tax rate	33.99%	10.7%

Case study
1. Overall structure



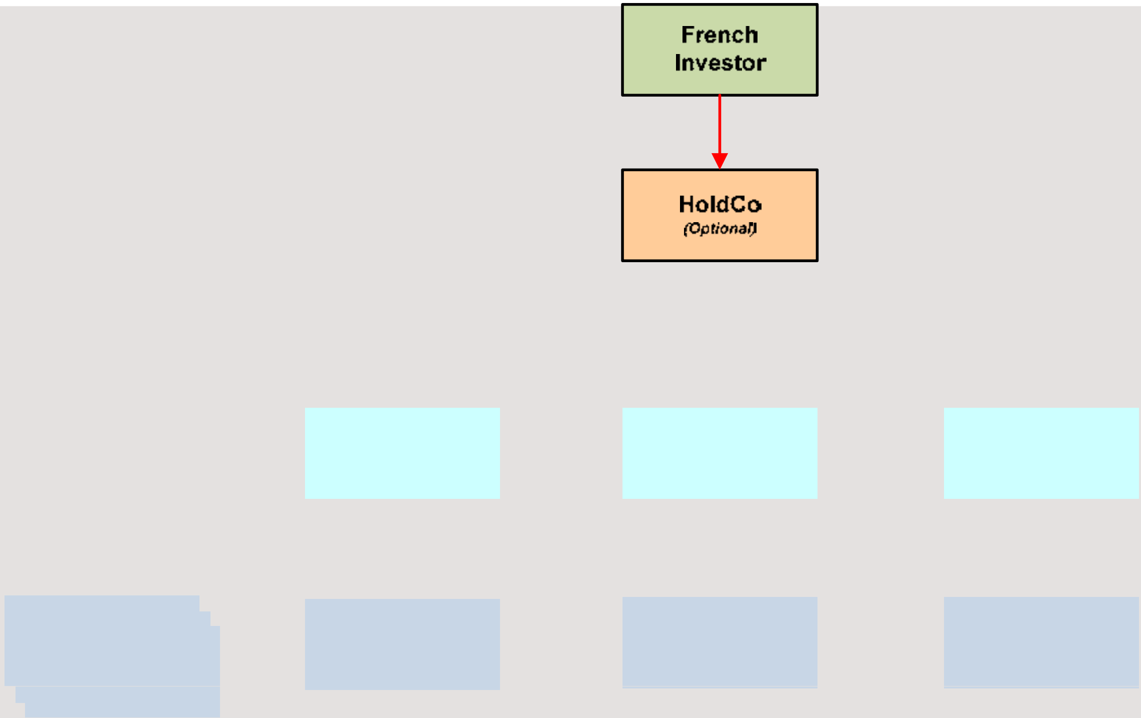
Case study

1. Overall structure (cont'd)

- French investor contemplating the acquisition of Target companies which are notably located in Hungary, Poland and Russia
- The acquisition could be realised through a top holding company (HoldCo) located in a typical holding jurisdiction such as the Netherlands, Luxembourg or Cyprus
- To acquire the Target companies, the investor (or its holding company) would be set up in each target jurisdiction a local holding company (Hungarian/Polish/Russian HoldCo)
- Each local holding company would be financed (either directly by the investor or through the top holding company) by a mix of hard equity and subordinated loan, and by bank loans (acquisition financing). Each target company would already be financed by a bank loan (former financing)
- Once the acquisition completed, each local holding company would be consolidated for tax purposes with the relevant target company, so that the profits of the target company can be offset against interest expenses incurred upon acquisition

Case study

2. Choice of the HoldCo



Case study

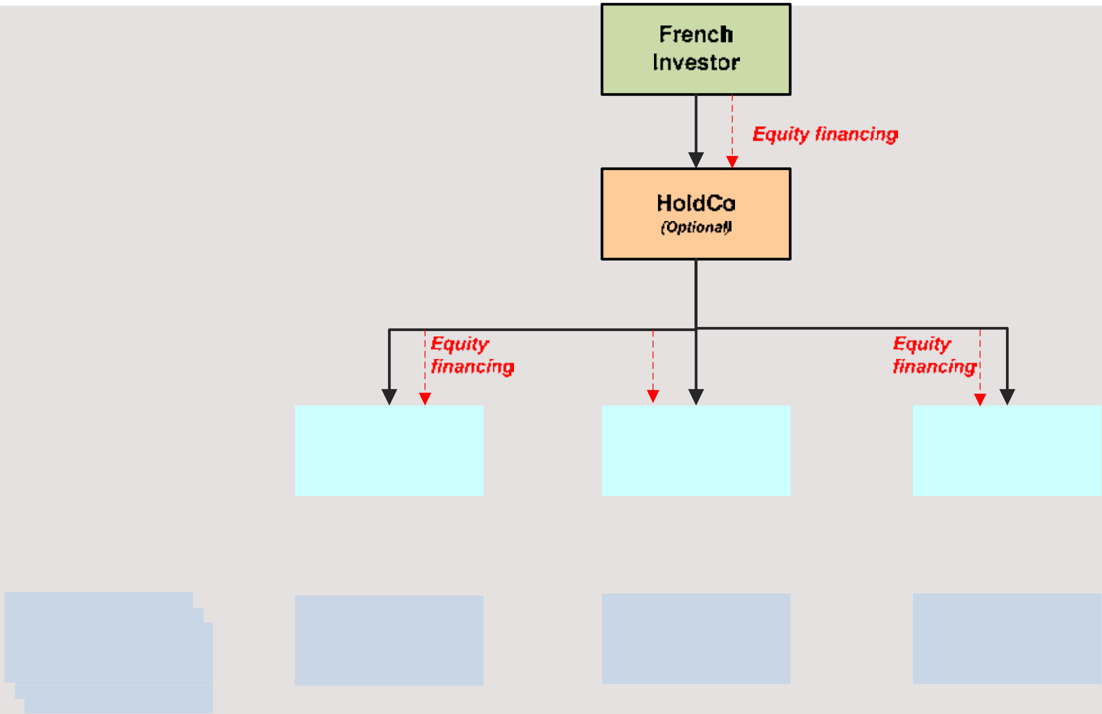
2. Choice of the HoldCo (cont'd)

Taxation of capital gains				
Holding Company	France*	Cyprus	Luxemburg	The Netherlands
Target Company				
Hungary	Capital gains on sale of shares in Hun HoldCo exempt from taxation in Hungary.			
Poland	Capital gains on sale of shares in Pol HoldCo exempt from taxation in Poland, unless the French company sells a Polish real estate company.	Capital gains on sale of shares in Pol HoldCo exempt from taxation in Poland.		
Russia	Capital gains on sale of shares in Rus HoldCo exempt from taxation in Russia, unless the French company sells a Russian real estate company. Capital gains on shares in a Russian real estate company acquired after 1 January 2011 and held by the French company for more than 5 years tax exempt in Russia.	Before 1 January 2016*: capital gains on sale of shares in any Rus HoldCo exempt from taxation in Russia; After 1 January 2016*: capital gains on sale of shares in a Russian real estate company tax exempt if acquired after 1 January 2011 and held by the Cypriot company for more than 5 years. *Assuming Protocol to the Russian-Cypriot DTT signed in October 2010 is ratified by end of 2011.	Capital gains on sale of shares in Rus HoldCo exempt from taxation in Russia.	

** France: Capital gains upon the sale by a French company of qualifying shares (portfolio shares held for at least two years) are 95% tax exempt, the balance of the capital gain being taxed at the standard CIT rate (maximum effective rate of 1.72%).*

Case study

3. Equity financing



Case study

3. Equity financing (cont'd)

Stamp tax	
Hungary	No stamp tax on debt or equity financing
Poland	As a rule, equity financing is subject to 0.5% TCLT. The TCLT does not apply to financing through premium. Shareholder loans are exempt from TCLT. Non-shareholder loans are subject to 2% TCLT, but there are a number of exemptions. E.g. according to the most common interpretation, a non-shareholder loan which is granted from abroad is not subject to TCLT if the loan agreement was signed abroad and if the funds lent are deposited on a non-Polish bank account on the date of the loan
Russia	No stamp tax on debt or equity financing

Case study

3. Equity financing (cont'd)

Interest deduction	
Hungary	As a rule interest constitutes a tax deductible cost on cash basis. Thin capitalisation rules provide for a debt/equity limit of 3:1. They cover any debt financing provided to a company, including bank loans. Excess interest is not tax deductible, but it should not be recharacterized into a dividend payment. There are no specific anti-abuse rules relating to interest deduction.
Poland	As a rule interest constitutes a tax deductible cost on cash basis. Thin capitalisation rules provide for a debt/equity limit of 3:1. They apply only to direct shareholder's loans (and sister company loans). Excess interest is not tax deductible, but it should not be recharacterized into a dividend payment. Financing provided by other entities (e.g. grand parent company) is not limited by thin capitalisation rules. There are no specific anti-abuse rules relating to interest deduction.
Russia	The Russian tax law is not quite clear on the method of interest deduction. The Ministry of Finance takes a position that interest should be tax deductible on accrual basis. However, Supreme Arbitration Court ruled out that interest should be deducted on cash basis, and the tax authorities tend to follow this view. Thin capitalisation rules provide for a debt/equity limit of 3:1. They apply only to loans granted or guaranteed by a foreign company owning directly or indirectly more than 20% of the borrower's capital. Excess interest is not tax deductible and it may be recharacterized into a dividend payment. Russian legislation allows for full deductibility of interest not subject to thin capitalization rules provided that the relevant interest rate is within 20% deviation up or down from the rate on comparable loans. In the absence of such comparable loans, currently the tax authorities accept the rate of interest of 6,2% on loans denominated in a foreign currency. These anti-abuse rules will not apply if the relevant double tax treaty (e.g. Russian-French) states so.

Case study

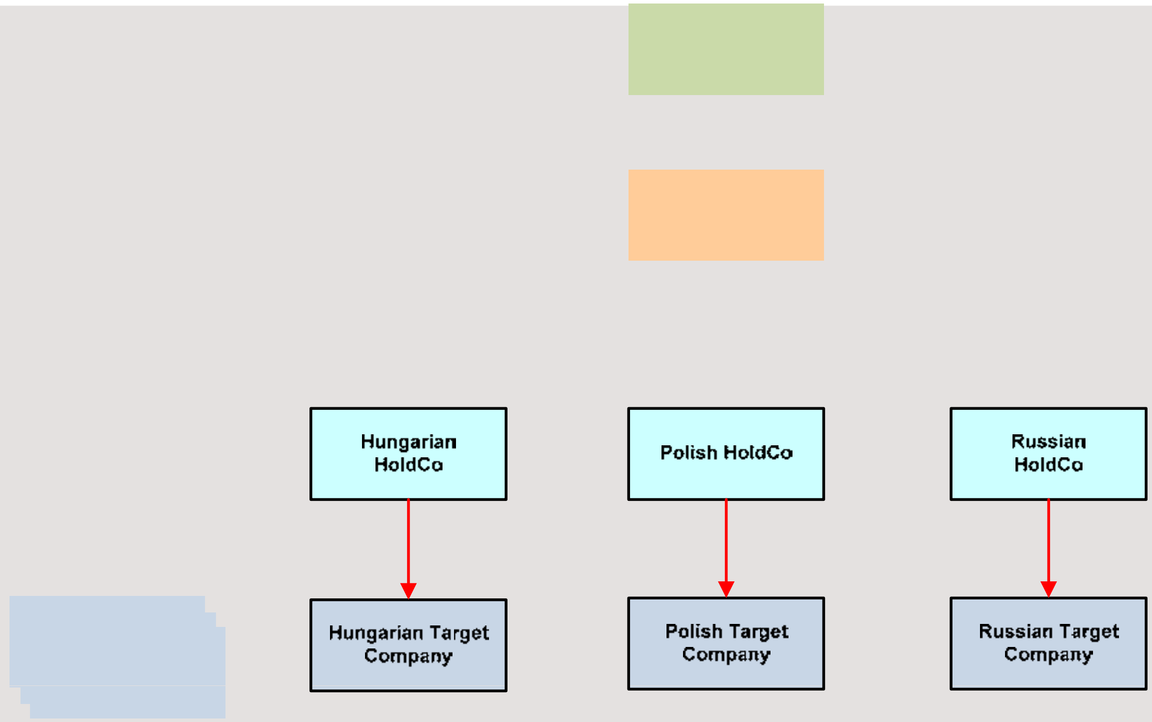
3. Equity financing (cont'd)

Dividend and interest payments				
Holding Company	France*	Cyprus	Luxembourg	The Netherlands
Target Company				
Hungary	Dividends exempt under the Parent Subsidiary rule. Interest exempt from withholding tax.			
Poland	Dividends exempt under the Parent Subsidiary rule. Interest exempt from withholding tax.	Dividends exempt under the Parent Subsidiary rule. Interest subject to 10% withholding tax.	Dividends exempt under the Parent Subsidiary rule. Interest subject to 10% withholding tax.	Dividends exempt under the Parent Subsidiary rule. Interest subject to 5% withholding tax.
Russia	Dividends are subject to 5%/10%/15% withholding tax. Interest is subject to 0% WHT	Dividends are subject to 5%/10% withholding tax. Interest is subject to 0% WHT	Dividends are subject to 10%/15% withholding tax. Interest is subject to 0% WHT	Dividends are subject to 5%/15% withholding tax. Interest is subject to 0% WHT

**France: qualifying dividends are 95% tax exempt, the balance of dividend income being taxed at the standard CIT rate (maximum effective rate of 1.72%).*

Case study

4. Purchase of shares in Target companies



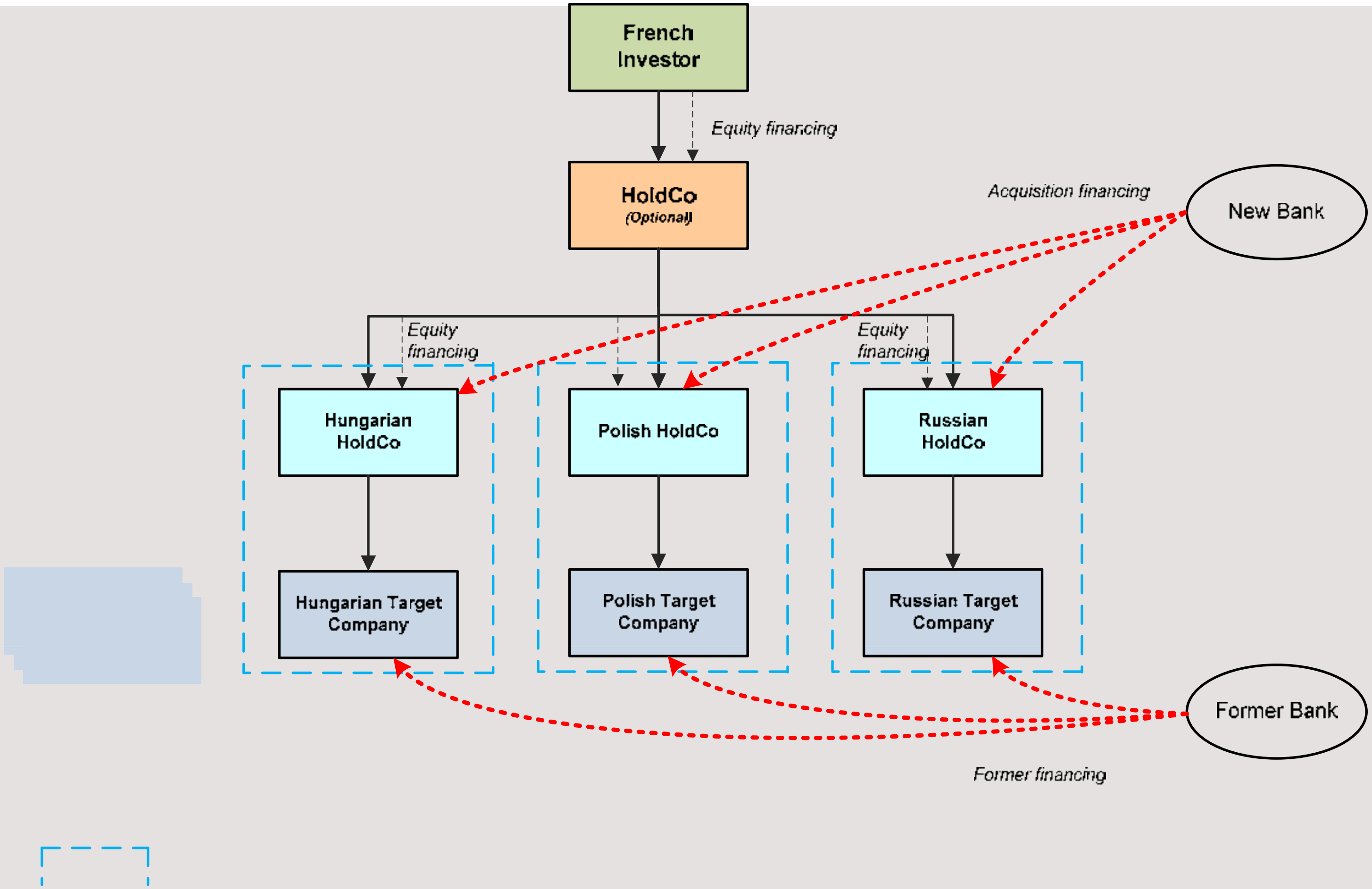
Case study

4. Purchase of shares in Target companies (cont'd)

Transfer tax on purchase of shares	
Hungary	The transfer of real property - and some other properties – for consideration is subject to transfer tax payable by the purchaser, calculated on the market value of the property purchased. The general duty on the transfer of real property is 4% of the market value up to HUF 1 billion (approximately EUR 3.6 million) and 2% for the excess (altogether capped at HUF 200 million - EUR 730k - per real estate). As for residential property, the duty on its transfer is only 2% for the first HUF 4 million (approximately EUR 14,500) and 4% above that amount of the market value. Generally, transfer tax is also levied on the indirect acquisition of real property, i.e. the acquisition (whether directly or through a chain of companies) of the shares in a company holding real estate, provided that the acquirer obtains at least 75% of the shares. For the purposes of the 75% threshold, shareholdings of relatives as well as that of related parties is aggregated. The tax base is the market value of the real estate prorated to the quota of the shares in question. Transfer tax exemption is granted if the transfer of share of a real estate holding company takes place between related parties. Due to the unfortunate wording, if transfer of the shares takes place between two foreign entities, the exemption may not apply.
Poland	Sale of shares in a Polish company is subject to 1% transfer tax
Russia	No transfer tax

Case study

5. Consolidation



Case study

5. Consolidation (cont'd)

	Merger	Fiscal unity	Conversion of target into a partnership	Liquidation
Hungary	Merger is tax neutral, utilisation of losses of the Target is available. In practice interest deduction on financing the acquisition could be challenged.	Not available	Not available	Taxable event. Interest deduction is available. The assets of the Target company are revaluated up to their market value. In some situations, the losses can be carried forward.
Poland	Merger is tax neutral, utilisation of losses of the Target is not available. Interest deduction is available.	Polish law provides for a concept of a tax group, but it is difficult to implement in practice.	Undistributed profits of the Target company will be viewed as a payment of dividend (which is exempt from tax under Parent Subsidiary rule). Interest deduction is available.	Taxable event, however, exempt from tax under Parent Subsidiary rule. Interest deduction is available. The assets of the Target company are revaluated up to their market value. The losses cannot be carried forward.
Russia	Merger is tax neutral, utilisation of losses of the Target is available. Interest deduction is available.	Not available, but the draft law is currently under consideration.	Undistributed profits of the Target company will be viewed as a payment of dividend. Interest deduction is available.	To liquidate the Target company, the debt must be repaid beforehand. Transfer of property is a taxable event. The losses cannot be carried forward.

Points of interest per country: ***Belgium***

Notional Interest deduction

— What is it?

- Innovative measure enabling all companies subject to Belgian corporate tax (or non-resident corporate tax) to deduct from their taxable income a fictitious interest calculated on the basis of their shareholder's equity (net assets)

— Purpose

- <u>Generally:</u> to reduce the tax discrimination between debt financing and equity financing
- <u>More specifically:</u> to "counterbalance" the repeal of the specific tax regime applicable to coordination headquarters

— Effects in Belgium

- General reduction of the effective corporate tax rate and a higher return after tax on investment
- Promotion of capital-intensive investments in Belgium and an incentive for multinationals to allocate such activities as notably intra-group financing, central procurement to a Belgian group entity

Points of interest per country: ***Belgium***

Notional Interest deduction (cont'd)

— How does it work?

- The amount that can be deducted from the taxable base equals the fictitious interest cost on the "adjusted equity capital"
- If the company makes insufficient profit, the deduction can be carried forward during the following seven (financial) years

— Qualifying equity ("adjusted equity capital")?

- Equity capital (which includes capital, share premiums, revaluation gains, reserves, profits/losses) as stated in the company's opening balance-sheet reduced notably by:
  - — The fiscal net value of own shares
  - — The fiscal net value of financial fixed assets qualifying as "participations and other shares" (non-portfolio participations)
  - — The fiscal net value of shares issued by investment companies

Points of interest per country: ***Belgium***

Notional Interest deduction (cont’d)

- The net equity assigned to foreign permanent establishments or real estate property or rights (situated in a country with which Belgium has concluded a tax treaty)
- The net book value of tangible fixed assets, if costs do not unreasonably exceed professional needs
- The book value of tangible fixed assets that are considered as an investment not acquired in order to produce a regular income
- The book value of real estate where its use is granted to directors (their spouses or children)
- Tax-free revaluation gains and capital subsidies

Points of interest per country: ***Belgium***

Notional Interest deduction (cont'd)

— Rate

- It is equal to the annual average of the monthly published interest rates for 10-year linear Belgian government bounds ("OLO's") over the year taken two years before the fiscal year concerned (e.g. the average of the interest rates of 2008 for fiscal year 2010)
- The interest rate for accounting year 2011 will amount to 3.425% (Vs. 3.80% for 2010)
- Small and medium sized companies are entitled to an upgrade of 0.5% (i.e., 3.925% for 2011)
- The interest rate is not allowed to deviate more than 1% from the rate of the previous tax year and must not exceed 6.5%
- If the financial year of a company is shorter or longer than 12 months, the reference notional interest rate is multiplied by the number of days in this financial year and divided by 365

Points of interest per country: ***Belgium***
Notional Interest deduction (cont'd)

— Special features

- If the company makes insufficient profit, the deduction can be carried forward to the following seven years
- The notional interest cannot be deducted from received abnormal or gratuitous benefits
- In case of change in control of a company, the carry-forward privilege is only maintained when such a change can be justified for financial or economic reasons
- No withholding tax on the notional interest deduction
- No acknowledgement (or ruling) is required for the notional interest deduction to apply; the only formal condition to comply with is the completion of an enclosure with the corporate tax return

Points of interest per country: ***Belgium***

Notional Interest deduction (cont’d)

— Example

P&L account	Before notional interest deduction	With notional interest deduction
Share capital	10,000	10,000
Profit before tax	500	500
Notional interest deduction (3.8%)	-	- 342.5
Taxable	500	157.5
Corporate tax (33.99%)	169.95	53.5
Effective tax rate	33.99%	10.7%

Points of interest per country: ***France***

Thin capitalization rules

General Comments on deduction of interest expenses and thin capitalization rules

French tax law strictly regulates the tax deduction of interest expenses incurred ***upon loans granted by related parties***. The rules governing the tax deduction of interest expenses can be summarized as follows:

1. Limitation on interest expenses deductibility for loans granted by third parties

If the level of debt is excessive by comparison with the financial strength of the borrowing company or if the interest rate may be qualified as excessive in comparison to market rates, the French tax authorities might challenge the deduction of the said interest on the grounds of the abnormal act of management doctrine ***even for loans granted by third parties***.

The risk regarding the level of debt may be mitigated by demonstrating that cash flow forecasts of the borrowing company meet the requirements for servicing the debt and by demonstrating that the company does not fall short of cash to meet its liabilities.

It is very important to be able to show ***comparable terms of loans*** with similar characteristics in the course of a tax audit.

Points of interest per country: ***France***

Thin capitalization rules (cont'd)

2. Limitation on interest expenses deductibility for loans granted by related parties

2.1. Limitations set out by article 39-1-3° FTC

Under article 39-1-3° FTC, interest owed by a French entity to its ***direct shareholders*** may only be deducted from the borrower's taxable income under the following limitations:

- If the share capital of the borrower is ***fully paid-up***;
- Interest accruing on direct shareholder loans ***does not exceed a specific annual average interest rate*** (*3.82% for FY 2010*).

Points of interest per country: ***France***

Thin capitalization rules (cont'd)

2. Limitation on interest expenses deductibility for loans granted by related parties

2.2. Limitations set out by article 212 FTC

The provisions of article 212 FTC apply to interest expenses accrued by a French company on borrowings from related companies in the meaning of article 39-12 FTC, i.e. (i) from a shareholder which holds directly or indirectly the majority of the share capital of the borrower, (ii) or from companies of which the majority of the share capital is directly or indirectly held by the same ultimate shareholder as the borrower, (iii) or *de facto* managed by the same ultimate entity.

Under the Finance Bill for FY 2011 (applicable to fiscal years ending as from 31 December 2010), bank debt whose reimbursement is secured by a related entity will also fall into the scope of article 212 FTC.

Certain exceptions have however be set out, in respect of funds lent:

- in relation to bonds issued within the context of public offerings
- up to the amount whose reimbursement is exclusively secured by a pledge on the shares of the borrowing entity (or receivables of the latter) or on the shares of the entity holding the shares in the borrowing entity provided that the holder of said shares and the borrowing entity are part of a same fiscal unity
- subsequently to the reimbursement of a preexisting debt, ***as a condition set out within the context of a change of control of the borrowing entity***
- in relation to loans concluded before 1st January 2011, ***within the context of the acquisition of shares or within the context of the refinancing of the latter operation*** (e.g., notably LBOs).

Points of interest per country: ***France***

Thin capitalization rules (cont'd)

2. Limitation on interest expenses deductibility for loans granted by related parties

2.2. Limitations set out by article 212 FTC (Cont'd)

Related party interest falling within the scope of the above provisions is tax-deductible only to the extent it meets the following two tests.

Test 1: Arm's Length Test

The interest rate is capped at the higher of the following two rates:

- ***Average of annual interest rate on loans granted by financial institutions which carry a floating rate and have a minimum term of 2 years*** (*3.82% for FY 2010*), as defined by article 39-1-3° FTC; or
- Interest rate at which the company could have borrowed from any unrelated financial institutions (e.g., banks) in similar circumstances.

The portion of interest that exceeds the higher of the above two thresholds is ***not tax-deductible in an irrevocably manner*** and must accordingly be added-back for the determination of the company's taxable income for the relevant fiscal year.

Points of interest per country: ***France***

Thin capitalization rules (cont'd)

2. Limitation on interest expenses deductibility for loans granted by related parties

2.2. Limitations set out by article 212 FTC (Cont'd)

Test 2: Thin-Cap Test

The amount of interest that meets the Arm's Length Test (Test 1) is tax-deductible provided that it meets the thin capitalization requirements below.

General rule: Application of 3 cumulative thresholds

Arm's length interest exceeding the following 3 cumulative thresholds is not tax-deductible under the thin capitalization provisions:

(i) Debt-to-equity ratio threshold:

Interest which meets the Arm's Length Test x 150% of the Net Equity (on the opening or closing date of the FY at the option of the company)

Indebtedness of the French borrowing company borrowing from related companies (as defined under article 212 FTC)

Points of interest per country: ***France***

Thin capitalization rules (cont'd)

2. Limitation on interest expenses deductibility for loans granted by related parties

2.2. Limitations set out by article 212 FTC (Cont'd)

Test 2: Thin-Cap Test (*Cont'd*)

(ii) Earnings threshold:

25% x [*Net operating income*
+ *Financial income*
+ *Tax deductible interest expenses under the Arm's Length Test*
+ *Amortization allowances (excluding exceptional amortization allowances)*
+ *specific lease payments*]

(iii) Interest income threshold

Interest received by the French company from related companies (as defined in article 212 FTC general scope). It should be noted that the above thresholds apply at the level of each borrowing company on a stand-alone basis.

Points of interest per country: ***France***

Thin capitalization rules (cont'd)

2. Limitation on interest expenses deductibility for loans granted by related parties

2.2. Limitations set out by article 212 FTC (Cont'd)

Test 2: Thin-Cap Test (*Cont'd*)

If the interest (considered as tax deductible pursuant to the arm's Length Test) exceeds the 3 aforementioned cumulative thresholds, the portion of the said interest that exceeds the highest of the above thresholds is not tax-deductible (unless the excess amount of interest is lower than k€ 150).

The non-deductible portion of interest is added back to the taxable income of the borrowing entity, but it can, however, be carried forward to be deducted during subsequent fiscal periods. The amount which may thus be deducted has to be determined each year mainly on the basis of the earnings threshold (as defined above), bearing in mind that a 5% reduction applies each year to the balance of the interest carried forward as from the second fiscal year.

Safe harbor provisions

The above three thresholds which cap the allowable amount of interest do not apply where the French borrowing company is in a position to demonstrate that the consolidated debt-to-equity ratio of the group it belongs to is greater than the debt-to-equity ratio of the French borrowing company on a stand-alone basis (as per its statutory accounts). When determining the consolidated debt-to-equity ratio of the group, one should take into account (i) French and non-French affiliated companies and (ii) both consolidated net equity and consolidated group indebtedness (excluding inter-company debt).

Points of interest per country: ***France***

Thin capitalization rules (cont'd)

2. Limitation on interest expenses deductibility for loans granted by related parties

Specific limitations applicable to interest expenses incurred within a tax consolidated group

Notwithstanding the fact that each company belonging to a tax group must apply both the Arm's Length Test and the Thin-Cap Test at its level as if it was not a member of the group when determining its taxable result on a stand-alone basis, the excess interest which is not tax-deductible pursuant to the Thin-Cap Test cannot be carried forward by the company that has incurred the excess interest.

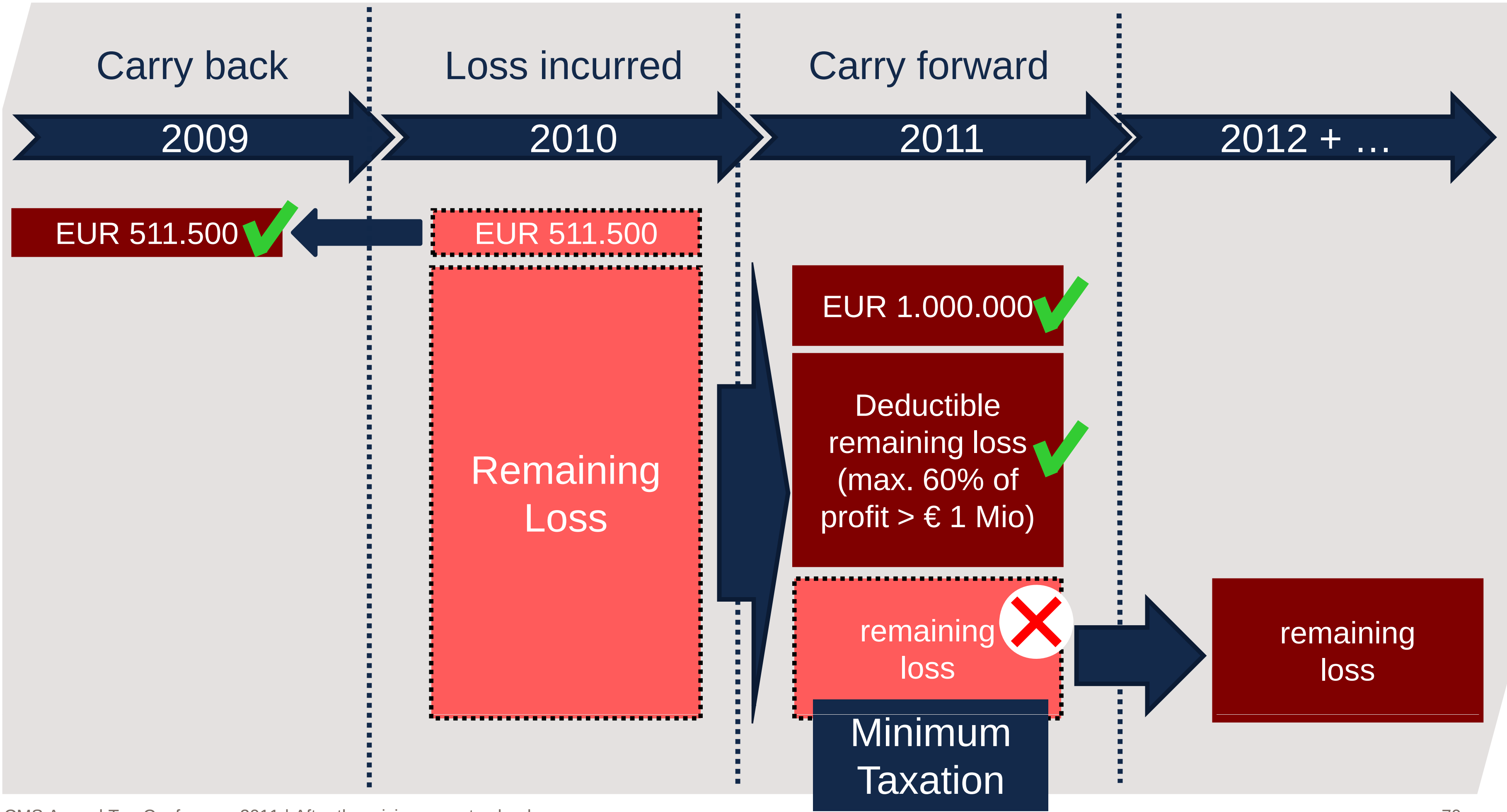
Indeed, the excess interest that exceeds the three cumulative thresholds set out above is surrendered to the head of the tax group which is entitled to carry forward the excess interest. Still, interest may be deductible depending on the outcome of the following computation:

The head of the tax consolidated group must first compute ***the difference between*** (i) the total amount of interest paid by the members of the tax consolidated group to related parties which are not included in that tax group (i.e., usually, foreign group entities) and (ii) 25% of the aggregated net taxable income of the members of the tax consolidated group, increased by depreciation allowances, certain lease payments and interest paid to related parties outside the tax group and reduced by dividends received from members of the tax group.

This difference between (i) and (ii) represents (when it is positive or equal to zero) the maximum theoretical amount of interest initially disallowed at the level of the group members which may be deducted from the group's consolidated tax result. The amount which may be effectively deducted under this "second chance" is equal to the sum of individual disallowed interest minus the abovementioned difference.

Points of interest per country: ***Germany***

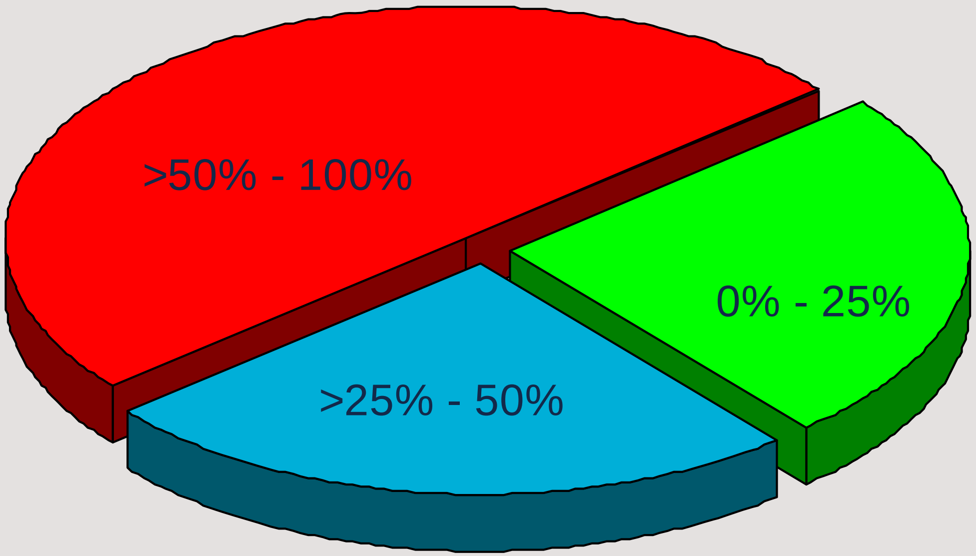
Use of Losses under German Tax Law: Loss Carry-Back/Forward



Points of interest per country: ***Germany***

Use of Losses under German Tax Law: Forfeiture of Loss Carry-Forward

Change of control in 5 years
(one purchaser or joint group of purchasers)



Loss Carry-Forward

- Preservation
- Pro-Rata
- Full Forfeiture

EXEMPTIONS

Points of interest per country: ***Germany***

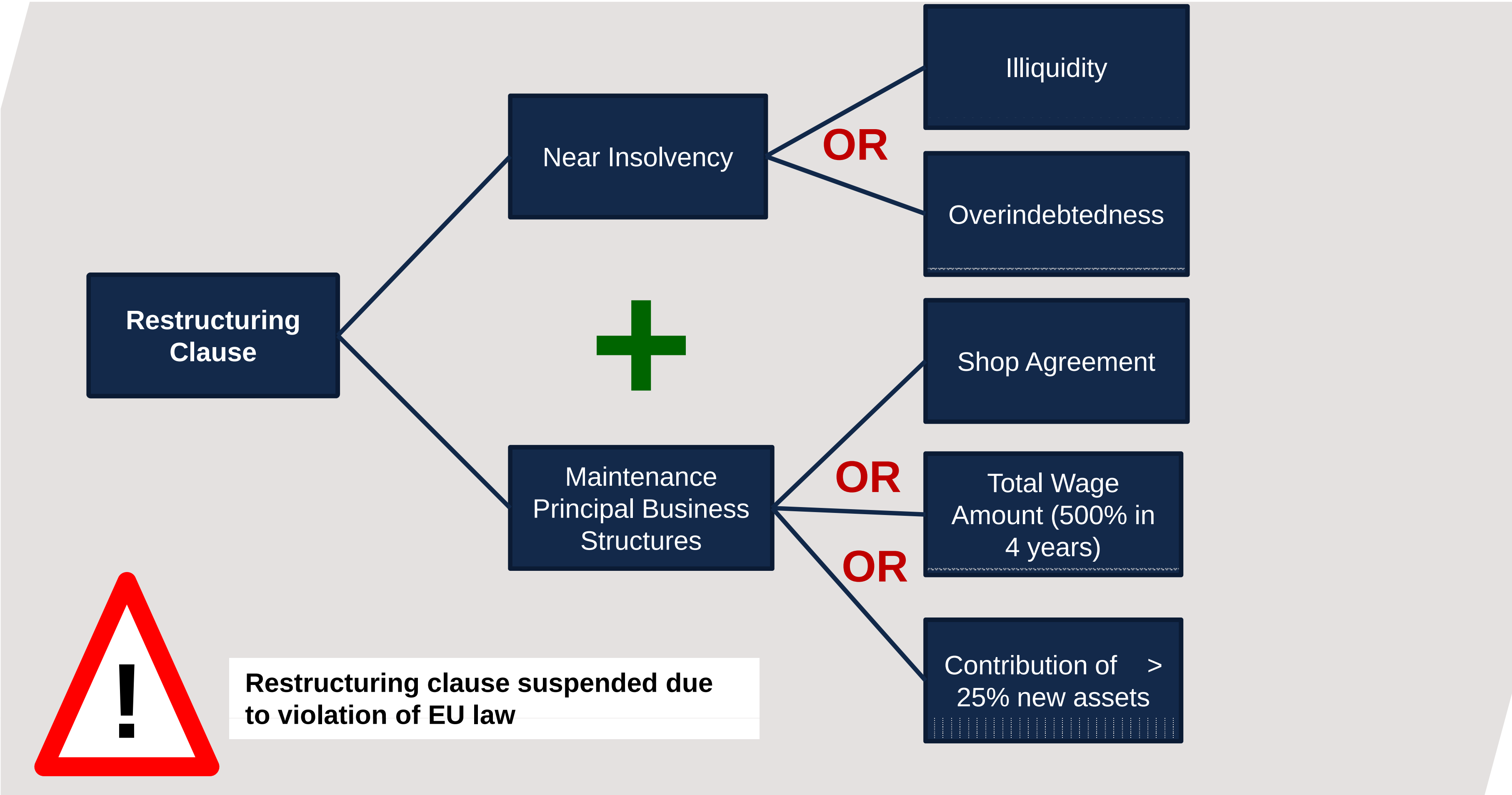
Use of Losses under German Tax Law: Forfeiture - Exemptions

EXEMPTIONS

- **I. RESTRUCTURING CLAUSE**
- **II. GROUP CLAUSE**
- **III. SAFE HAVEN**

Points of interest per country: ***Germany***

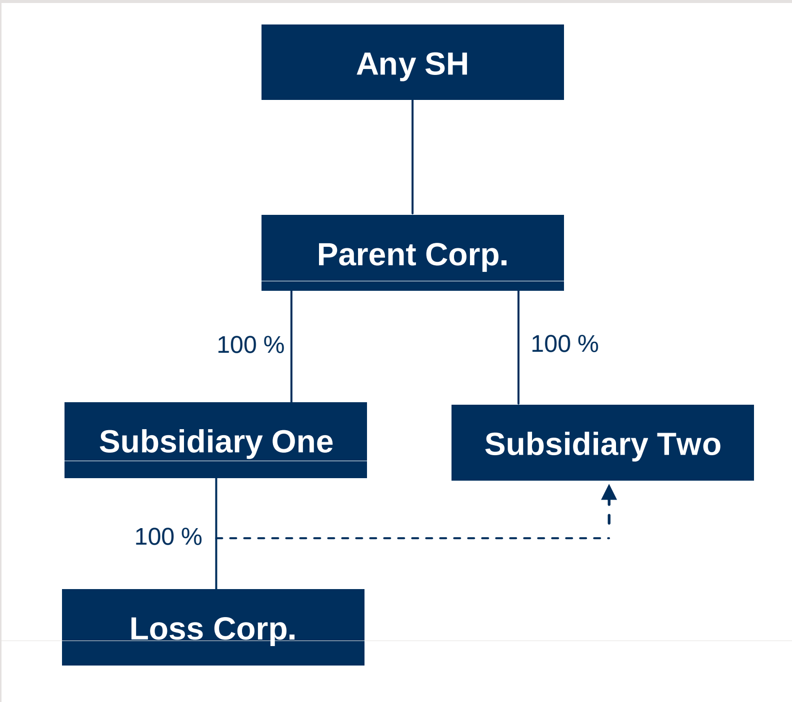
Use of Losses under German Tax Law: Forfeiture – Restructuring Clause



Points of interest per country: ***Germany***

Use of Losses under German Tax Law: Forfeiture – Group Clause I

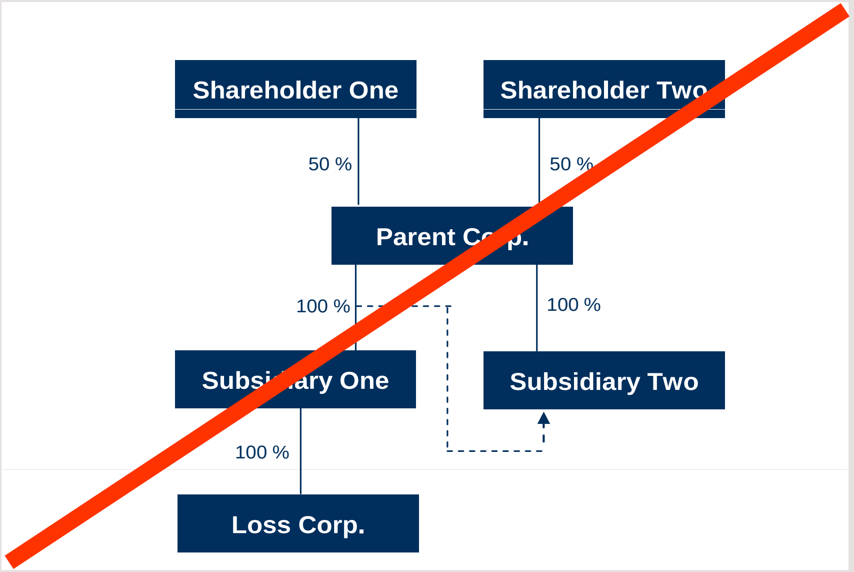
"… all equity/voting rights of transferring entity and receiving entity are (in)directly held by **the same** shareholder."

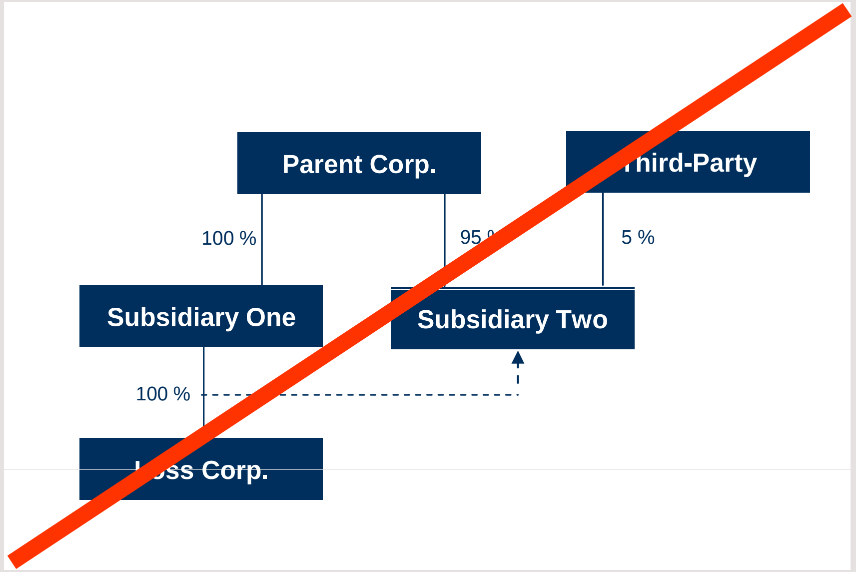


Shareholder Transferring Entity:
Parent Corporation
=
Parent Corporation
Shareholder Receiving Entity

Points of interest per country: ***Germany***

Use of Losses under German Tax Law: Forfeiture – Group Clause II



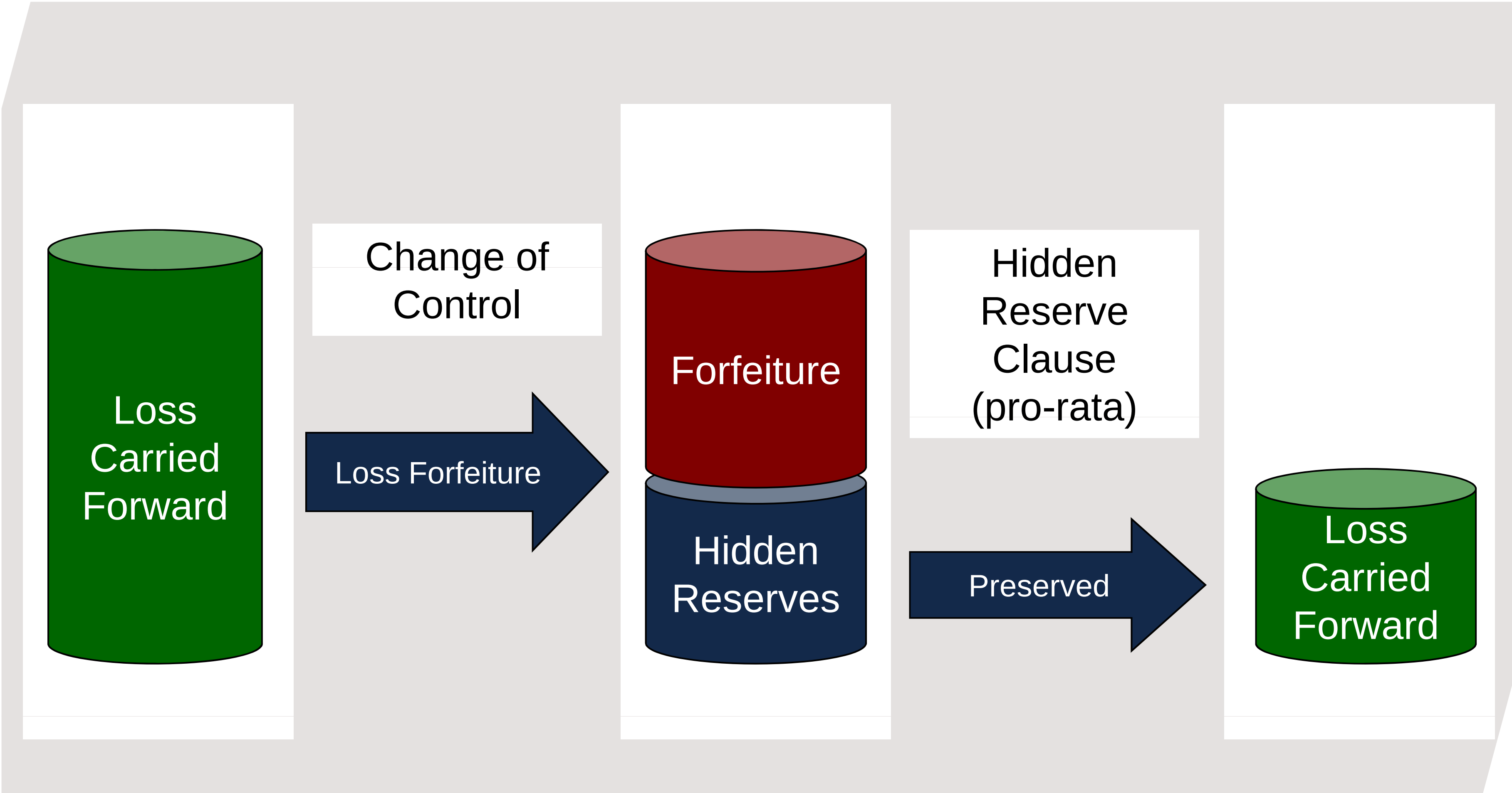


Shareholder Transferring Entity
Shareholder One + Two
≠
Parent Corporation
Shareholder Receiving Entity

Shareholder Transferring Entity
Parent Corporation
≠
Parent Corporation + Third Party
Shareholder Receiving Entity

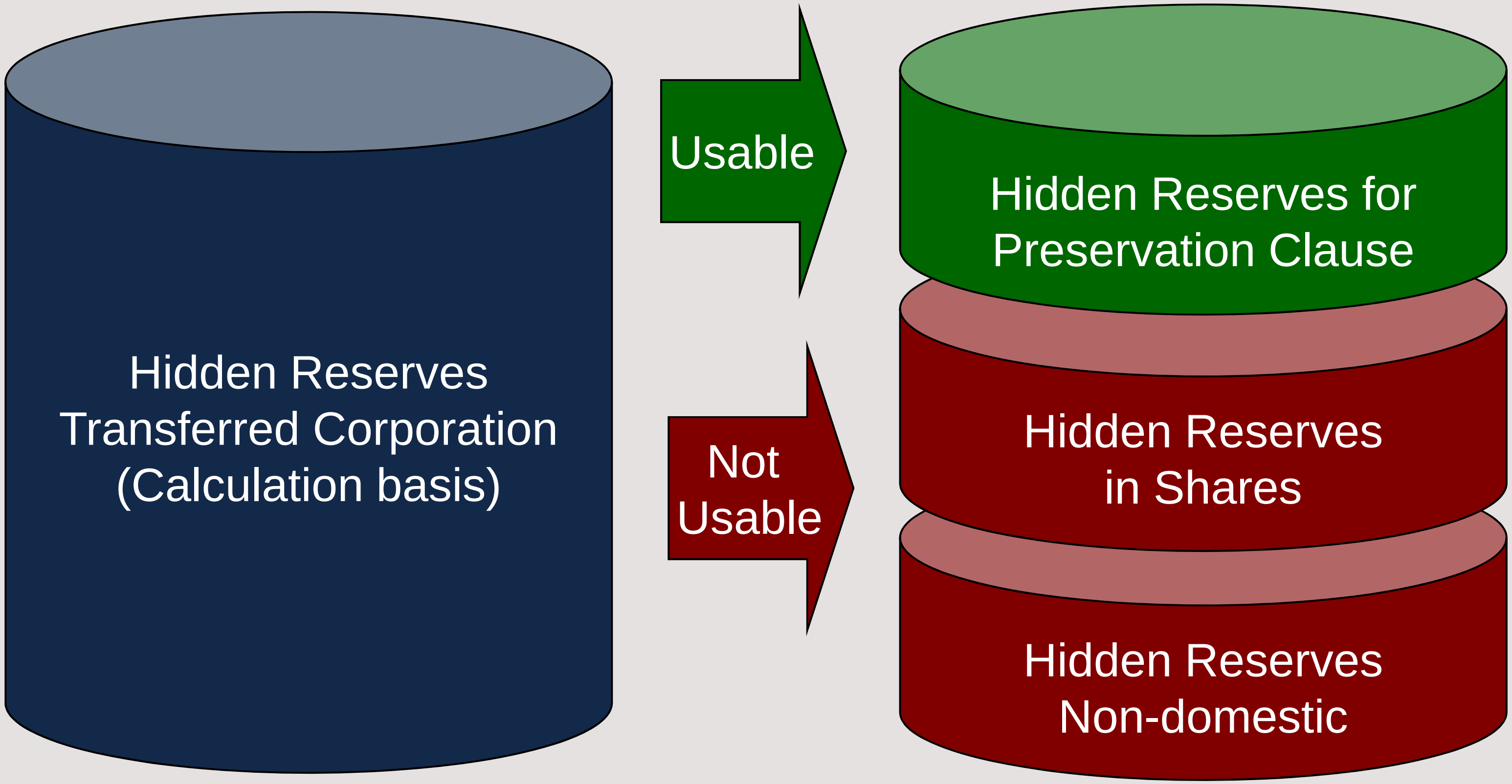
Points of interest per country: ***Germany***

Use of Losses under German Tax Law: Forfeiture – Hidden Reserve I



Points of interest per country: ***Germany***

Use of Losses under German Tax Law: Forfeiture – Hidden Reserve II



Points of interest per country: ***Italy***

Interest deduction for holding companies (cont'd)

— Basic rule (for companies different from banks, insurance companies and other financial institutions)

- Interest expenses are deductible for an amount corresponding to:
  - — Interest income accrued in the relevant FY (Step 1), and
  - — 30% of the EBITDA generated by the taxpayer in the relevant FY (Step 2).
- This rule applies to both related party debts and third party debts
- A carry forward mechanism (with no time limitation) provides that non-deductible interest in a given FY may be deducted against future capacity of the 30% EBITDA
- Unused EBITDA excess over interest expenses of one FY can be carried forward to increase EBITDA capacity of future FYs

Points of interest per country: ***Italy***

Interest deduction for holding companies

EXAMPLE 1 – Computation of non-deductible interest expenses	**FY X**
a) Value of production	100
b) Costs of production	50
c) Depreciations	10
d) Financial lease charges	10
e) EBITDA (a – b + c + d)	70
f) 30% of EBITDA	21
g) Interest expenses	50
h) Interest income	10
i) Net Interest Expenses (g – h)	40
Step 1) Interest expenses deductible within the limit of interest income	10
Step 2) Interest expenses deductible within 30% EBITDA capacity	21
l) Non-deductible interest expenses	19

Points of interest per country: ***Italy***

Interest deduction for holding companies (cont'd)

— Specific features for holding companies

- Holding companies typically lack of eligible EBITDA since their revenues are generally represented by dividends, interest and capital gains
- Interest expenses are therefore deductible only within the limit of interest income accrued in the relevant FY

— Remedies

- Option for tax consolidation
- Virtual tax consolidation
- Quick merger

Points of interest per country: ***Italy***

Interest deduction for holding companies (cont'd)

— Option for tax consolidation

- Non-deductible interest expenses pertaining to a consolidated entity (e.g. holding company) can be offset, and then deducted on a consolidated tax basis, against any excess of 30% EBITDA realized by other entities pertaining to the tax group

- Timing features !

Points of interest per country: ***Italy***

Interest deduction for holding companies (cont'd)

EXAMPLE 2 – Deduction of interest expenses within the tax group						
FY X	Interest expenses	Interest income	Net Interest Expenses (A)	30% EBITDA (B)	Non deductible NIE (C=A-B)	30% EBITDA excess (D=B-A)
Holding Company	12.000	4.200	7.800	0	7.800	Zero
Company A	16.700	Zero	16.700	5.500	11.200	Zero
Company B	22.300	8.950	13.350	25.350	Zero	12.000
TOTAL					18.000	12.000*

* Interest expenses deductible from the consolidated taxable income

Points of interest per country: ***Italy***

Interest deduction for holding companies (cont'd)

— Virtual tax consolidation

- For the computation of deductible interest expenses the taxpayer is entitled to consider any excess of 30% EBITDA pertaining to its foreign subsidiaries, provided they satisfy the conditions to elect for the domestic tax consolidation regime

— Quick merger

- Non-deductible interest expenses of the companies involved in a merger may be offset against future capacity of the 30% EBITDA of the company resulting by the merger. However, interest expenses can be carried forward within the same limitations applicable, in case of merger, to tax losses

Points of interest per country: ***Spain***

Anti-abuse “Abusive” administrative practice

— According to Spanish law, deductibility of interest expenditure in Spain is subject to the following conditions:

- Record of the expense in the accounts of borrower
- Thin capitalization rules, where applicable
- Arm’s length rules

related party transactions

— There is no specific anti-abuse provision in the environment of acquisition financing

— The wording of the applicable law is very clear and does not need further interpretation

Points of interest per country: ***Spain***

Anti-abuse "Abusive" administrative practice (cont'd)

— However, the Spanish tax authorities ("STA") deny, as a rule, the deductibility of interest expenditure for intra-group acquisitions when

A Spanish entity funded with debt acquires a stake in a foreign entity, especially (but not necessarily) if such stake was previously held by another group company.

— This type of internal group's reorganizations, not well regarded by the STA, has been frequent in the past years due to:

- Former Spanish provision entailing the depreciation of financing goodwill (now abolished).
- Deductibility of interest expenditure even when the stake acquired qualifies for the "participation exemption regime".

Points of interest per country: ***Spain***

Anti-abuse "Abusive" administrative practice (cont'd)

— The procedural tools for the STA to attack these schemes:

- General anti-abuse provision (a sort of "substance over form" approach)
  - — It requires a special procedure ⟶ difficult for the STA to comply with properly
  - — The outcome is the re-characterization of the interest expenditure as "non deductible" but no penalties can be imposed

- Simulation
  - — Vague and wide concept: difficult to ascertain what falls within its scope
  - — The outcome is also the non deductibility of interest expenditure but here penalties can be imposed
  - — If the amounts at stake are above €120,000 a "simulated" scheme can fall within the scope of tax criminal offences

Points of interest per country: ***Spain***

Anti-abuse “Abusive” administrative practice (cont'd)

— The STA tend to follow the “Simulation” route to challenge “controversial” schemes

- The file is then sent to the Criminal Court where, in case of Sentence, the Judge should rule, not only on the existence of a criminal offence but on the deductibility of the interest expenditure (with no further referral to the Tax Court)
- In order to avoid that a resolution (verdict of non guilty) of a Criminal Court against the STA would prevent the latter from further inquiry, the STA are interpreting that the “Simulation” has different characters in the civil/criminal or in the tax procedure, and accordingly that it is possible to reopen the “Simulation” route in a further administrative stage
- There is a high uncertainty about when and who is going to rule on the substantive and procedural aspects of these cases.

Points of interest per country: ***Spain***

Anti-abuse "Abusive" administrative practice (cont'd)

— In our opinion

- Aggressive schemes could not be attacked through "Simulation" but through the general anti-abuse principle (sort of "Substance over form" approach)
- In order to avoid that a given scheme is challenged under the "Substance over Form" principle, beyond the achievement of a tax benefit, there must be sound economic reasons supporting the scheme*

(*) Based on the belligerent attitude of the STA at all circumstances, we would recommend the existence of valid economic reasons for ALL business operations of tax payers in Spain.

Points of interest per country: ***UK***

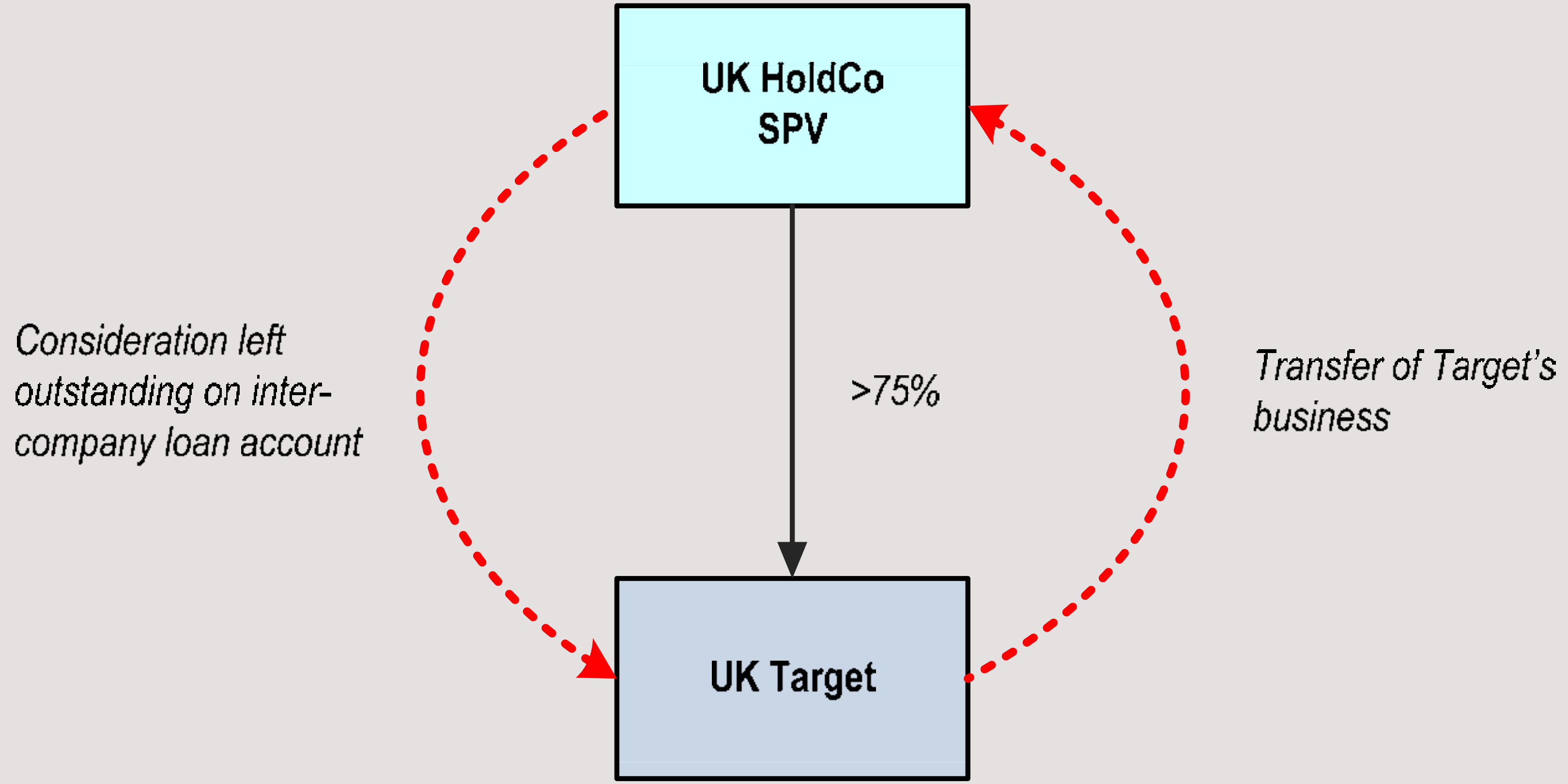
The problem on acquisition of Target

— Two UK risks on acquisition and retention in existence of Target are of current relevance:

- If insufficient profits in Target to group relieve interest deduction (for payments to bank/connected parties) in UK Holdco SPV then such excess interest only available to carry forward and set off against future non-trading income and capital gains in UK Holdco SPV. This issue is particularly relevant now UK has tax exemption on sale of shares in trading subsidiaries (SSE) i.e. no taxable profit on exit against which to set excess interest
- If Target has carry forward trading losses, a change in the nature of or the way the trade of Target is carried on post-acquisition (e.g. in order to try to turn the business around) can forfeit the benefit of the losses

Points of interest per country: ***UK***

The solution: hive-up mechanism



Points of interest per country: ***UK***

The hive-up mechanism

— Tax neutral transfer of trade from Target up to HoldCo

- CGT, SDLT/SDRT and VAT group reliefs
- Election for stock and other trading assets to be transferred at a tax-neutral price

— Target's losses

- Target's entitlement to capital allowances and carried forward trading losses should be preserved in HoldCo even if the trade of Target is altered after hive up into UK Holdco SPV
- Capital losses remain in Target

— Interest expenses on operational loan

- Interest will continue to be off settable against trading profits arising from the transferred trade through a debtor novation

Points of interest per country: ***UK***

The hive-up mechanism (cont'd)

— Interest expenses on acquisition loan

- If there is pre-acquisition and pre-funding evidence (e.g. board minutes etc) that UK Holdco SPV is intending to acquire the trade through the mechanism of the acquisition of Target and the hive up, the interest should be viewed as a trading expense for UK Holdco SPV and therefore off settable and carried forward against current and future trading profits once the business has improved

Points of interest per country: ***UK***

The hive-up mechanism (cont'd)

— Timing

- If there are carry forward trading losses in Target, it is inadvisable for the hive-up to be effected as part of HoldCo's acquisition of Target
  - — Risk that HMRC argue that Target did not beneficially own the trade after completion of HoldCo's acquisition of Target
- It is best if the hive-up is deferred until the end of the month of Target's acquisition at the earliest
- However, to maximise the ability to treat interest on the acquisition debt of UK Holdco SPV need to hive up asap

Points of interest per country: ***UK***

The hive-up mechanism (cont'd)

— Why not liquidate Target?

- Avoidance of CGT issue on Target's historic capital assets thanks to the hive-up prior to the liquidation while tax group still exists
- If Target's shares increase in value after acquisition, there is a 12-month-holding requirement for the substantial shareholding exemption to apply
- More common alternative: Target is left dormant post hive-up and then eventually struck off