

Merger & Hole news update



I am delighted to say that a lot of very positive things have been happening in Mercer & Hole since our last Bulletin and I am particularly pleased that David Mansell joined us as a partner on 5 November 2007. David was a partner in Mazars based in their Nottingham office before joining Mercer & Hole.

A chartered accountant and a chartered tax advisor, David spent time prior to joining Mazars with BDO Stoy Hayward, KPMG and Midland Bank, now HSBC. He brings a huge experience to Mercer & Hole and we are delighted that he has joined us.

Based largely in our Northampton office, David's primary role is as a corporate and business tax partner. However, he does also have responsibility for private clients in our Northampton and Milton Keynes offices. I very much hope that many of you will get the chance to meet him soon.

I am also delighted that our Transactional Support Services have grown to such an extent that we have been able to promote Julian Dobbin, based in our Milton Keynes office, to director, to run this area of our work. Apart from acting for clients when they acquire new businesses or dispose of an existing one, we carry out a very large number of due diligence exercises for financial institutions and it is Julian that is responsible for this. In fact you will see an article from him later in this Bulletin.

I am also pleased that Gordon Bowden joined us on 2 January 2008 to take responsibility for our Financial Services team. Gordon is vastly experienced and I hope that many of you will have a chance to meet him in the forthcoming months.

Our students studying for professional qualifications have an exceptionally good exam record, but I was particularly pleased with our exam results announced recently showing of the five students sitting their final papers to qualify as chartered accountants, Kathryn Goodhew, Chetan Mistry, Alberto Di Lorenzo and Rachel Crook all passing, with the fifth student narrowly missing out on just his case study. Congratulations to all of them!

Finally, I am very conscious that we introduced our new website and our blogs in the last Bulletin and we are delighted with their success. A lot of our professional contacts and clients are now "signed up" for the blogs and using them regularly and in fact Chris Laughton, one of our Insolvency partners in London, has been so successful with his blogging that he has ended up on two occasions being interviewed on the radio and very recently on the television about Northern Rock. I very much hope that those of you that have not dipped into our blogs will get the chance to do so in the near future.

Companies Act 2006



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The Companies Act 2006 is being introduced in stages many of which have already taken place.

The next round of changes takes place in April 2008 when:

- The requirement to have a Company Secretary is abolished
- Auditors get the ability to agree with clients limits to their liability for audit work undertaken
- The deadline for a private company to file its accounts reduces to nine months
- The deadline for a public company to file its accounts reduces to six months.

We are still to get a definitive split of what changes, that were originally due to take place in October 2008, will now be postponed until October 2009. However, it has been suggested that the likely split will be as follows:

October 2008

- Guidance re objections to company names

- Completion of the codification of directors' duties
- Abolition of the financial assistance rules for private companies
- An ending to the concept of authorised share capital
- The introduction of privacy rules on director's home addresses.

October 2009

- The introduction of new rules relating to share allotments
- The introduction of a new model form of Articles with the abolition of the Memorandum of Association.

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VAT and Funded Pension Schemes



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VAT is an area which is commonly overlooked by businesses when setting up and managing funded pension schemes.

The VAT position can be complex as the business may not view the pension fund as a separate legal entity and costs may be incurred by the business and recharged to the fund, without consideration of the VAT consequences.

Employer

The cost of setting up and the day-to-day management of a pension fund (e.g. actuarial valuations of funds assets) are part of an employer's normal business activity and as such, any VAT incurred on related costs is recoverable, subject to the VAT recovery position of the employer. However, the investment costs relate to the business activity of the fund and any VAT on such costs is not recoverable by the employer.

The fund, however, may be able to reclaim a proportion of VAT incurred on investment costs (e.g. rent collection, brokerage charges, advice relating to making investments etc). It is important that invoices from third parties are addressed to the correct entity to maximise VAT recovery.

Where fund managers are unable to provide separate invoices to the employer/fund, HMRC have to date, allowed the use of the "30/70 rule" to apportion the VAT on such invoices (30% to employer/70% to the fund). However, this treatment is currently under review.

Following the decision in a recent ECJ case, - JP Morgan Claverhouse Investment Trust plc/Association of Investment Trust Companies v HMRC, - that investment management services were exempt from VAT, there is a question over whether VAT exemption also applies to the management of pension funds. However, HMRC have issued guidance (Business Brief 58/07) that the decision does not extend to the management of pension funds. It is widely expected that further litigation will challenge this position and The National Association of Pension Funds is seeking support from its members to share the cost of mounting a legal challenge.

Subject to the type of investments made, the fund may be making taxable supplies and may be required to register for VAT. Alternatively, it may be possible to register on a voluntary basis. This would allow the fund to reclaim a proportion of the VAT incurred on investment costs. It may even be possible to apply for a retrospective VAT registration and obtain a refund of a proportion of the VAT incurred up to three years prior to the date of VAT registration.

Funds investing in commercial property may incur VAT on the acquisition of properties if the vendor has elected to waive exemption ("opted to tax") over their interest. If the property is acquired with tenants "in situ", this may be a "VAT free" transfer of a property letting business, subject to certain conditions. Rental streams will be exempt from VAT unless the fund also opts to tax its interest. This leads to a potential restriction of VAT on related costs such as professional fees and ongoing costs.

There are many pitfalls in the area of VAT and property and advice should always be sought at an early stage of negotiations.

Jane Stacey has recently joined Mercer & Hole as a Senior VAT Manager and brings a wealth of VAT experience spanning over 17 years. Jane assists clients on a wide range of VAT issues, including VAT planning, transaction support, VAT compliance and ad hoc advice on a variety of other issues.

Transaction Services – What do we do?



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The Transaction Services department is a relatively recent addition in the life of Mercer & Hole (the firm is 103 years old this year!). Therefore, it is probably useful to remind everyone what the department does.

Transaction Services is the succinct way of describing advice on buying and selling companies. In recent years, our partners have seen a sharp rise in the number of SME businesses involved in transactions, so much so that a department is now dedicated to this market.

Financial advice is clearly critical in a transaction. The three major areas we advise on are :

- **Financial Due Diligence** - These reports are designed to assist a potential buyer of a business - This principally involves the verification of past / future earnings and a review for un-recorded liabilities (such as tax). Our reports also provide readers with a full understanding of the financial history of the company. We undertake one or two due diligence assignments per month, for banks, private investors, venture capital funds and also acquisitive companies. Our clients generally find that the earlier our involvement in a potential transaction, the more value we can add to the process.

- **Company Valuations** - In any transaction, the buyer and seller are motivated to respectively inflate / deflate the valuation. Quality advice on a valuation does not involve unrealistic calculations. It should produce sensible and logical opinions on value which our clients can utilise to their benefit. We often prepare valuation reports and also review those prepared by others.
- **Projections** - Any investment decision relies on accurate financial projections. An integrated flexible model is an invaluable tool in this process, as it allows different scenarios to be quickly plotted from both a profitability and cashflow perspective. Again we are regularly involved in preparing financial projections, although we also evaluate models produced by third parties.

This is a short summary of what is quite a complicated area. If you have any questions relating to our services, please contact us.

Julian Dobbin is a qualified Chartered Accountant and a Director of the Transaction Services department. Julian has an extensive technical knowledge on company acquisitions, and spends the majority of his time undertaking Financial Due Diligence. He is also involved in company valuations and the preparation of financial projections. Julian also writes articles on the SME transactions market in the local business press and for our SME Plus blog.

Capital Gains Tax - Entrepreneurs' Relief



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When Alistair Darling made his first Pre Budget speech in October, he could barely have expected the furore that would greet his proposal to simplify the capital gains tax system by introducing a flat 18% rate for all disposals after 5 April 2008. But the idea of disregarding both taper relief since April 1998 and the effects of inflation for assets owned before that date, were enough to unite business owners and their advisers in condemning our new Chancellor's big idea.

After almost unprecedented lobbying (and four months of uncertainty) Mr Darling released details of his revised proposals and the introduction of what he and HM Revenue & Customs are calling "Entrepreneurs' Relief", in late January.

Under this new relief, which is set to become law from 6 April 2008, the self-employed, employees and directors will, if they and their business meet the necessary conditions, qualify for a 10% tax rate on selling their interest in the trading business or company for which they work. As ever, though, the detail makes the relief both more complicated and less attractive than it might initially appear:

- The relief applies only on the first £1million of gains made during someone's lifetime, so serial entrepreneurs, making a gain in one business and then moving on to their next venture, are unlikely to find the new proposal especially attractive.
- In order to qualify, an employee or director must hold, broadly, at least 5% of the company's shares, meaning that lower paid staff at companies such as Tesco, who are often referred to as a shining example of the small investor benefiting from Gordon Brown's taper relief, will be excluded from the Chancellor's new scheme.
- The shares, or interest in the business, must have been owned for at least one year.
- There is still no allowance made for inflation on those assets owned before April 1998, the proposed abolition of which caused almost as much unrest as the proposal to remove taper relief. It is easy to underestimate the effect that this will have for many long term investors. A husband and wife farming partnership, whose farm was worth £1,000,000 in 1982, could face a tax bill of £38,000 if they sold their farm for £2.5million before 6 April 2008. Waiting until after the end of this tax year would increase the tax liability to £148,000 (though it would have been nearly £270,000 without the new relief).

There are no significant changes to the capital gains treatment of other assets, such as investment company shares, residential "buy to let" properties, where the Chancellor's original plan to introduce an 18% rate from 6 April 2008 remains.

We are looking at the implications of these new rules for many clients; please contact us if you would like to discuss how these changes might affect you.

Real uncertainty on tax



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With effect from April of this year the government is introducing legislation to counter tax savings from "income shifting".

The problem is that the legislation is so widely drawn that it will almost certainly affect many privately owned businesses.

The legislation applies to businesses - companies and partnerships, possibly including property partnerships, although the position on the last is even less clear.

Broadly speaking the new provisions will require certain partnership profits and company dividends to be reallocated for tax purposes where such a reallocation would result in an increase in tax to the "correct" level.

The new provisions will potentially apply to situations where individuals are rewarded disproportionately for their efforts, expertise, capital contribution or risk. In these circumstances, all or part of their income may potentially be assessed on the person who, by virtue of his or her control or influence (not defined), provided the additional reward. The legislation will potentially apply to almost any business where the owners, partners or investors are linked in some way whether as family, civil partners or unmarried couples.

The Revenue guidance is worrying in that it confirms our worst fears about the potential scope of this proposed legislation, but it is relatively extensive. This can be reviewed at:

http://customs.hmrc.gov.uk/channelsPortalWebApp/channel_sPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_028192

Under self-assessment the onus is on individuals to decide if the provisions apply and to what extent. This places a huge burden on taxpayers - and their advisers!

Research & Development (R&D)



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R&D is a wide ranging relief that many businesses are not claiming because they do not recognise that they are undertaking research and development, e.g. product development and improvement, etc. There is an excellent leaflet at <http://www.berr.gov.uk/files/file36112.pdf> that gives examples of business that have qualified - the trades range from knife-making to construction to research.

R&D tax relief has recently become much more accessible to businesses; with the set up of the new specialist units with

Inspectors who state their brief is to give money away, making claims is much less onerous. However, to complicate matters, just when things were getting easier the Revenue have introduced a restriction on claims: from 31 March 2008 claims may only be made for the last two years rather than the potential six as is currently the case.

R&D is a valuable relief:

- 100% capital allowances
- 125% on qualifying costs for large companies and sub-contractor costs
- 150% for direct costs of SMEs.

The rates on the latter two should increase to 150% and 175% from April this year, subject to EU State Aid approval.

Time is running out - if you think you may have a claim we need to act quickly.

Pensions



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The tax benefits of personal pension funding are compelling. Payments to all approved pension schemes are subject to income tax relief.

In addition, contributions are invested in a fund that accumulates free of UK tax on investment income and capital gains, although it is no longer possible for pension funds to claim the tax credits on dividends from UK equities.

However, when the time comes for pension benefits to be realised many people are put off by the perceived lack of flexible options available. In particular, the apparent lack of value available for other family members in the event of premature death can cause particular angst.

For those for whom a pension fund is either wholly or partially surplus to income needs the following objectives are not uncommon:

- To defer taking a pension for as long as possible.
- A reluctance to buying an annuity.
- A desire to make sure that the pension fund is available for a spouse and children after death.

Meeting these objectives can be difficult and many people opt to delay drawing benefits for as long as possible in order to try to provide protection for their family. Indeed the best way to pass pension benefits to ones family is normally to die before drawing on them. Funds up to the value of the Pension Lifetime Allowance (£1,600,000 for 2007/08) should pass to nominated beneficiaries with no tax liability. Of course this is of no personal benefit and aspects of this strategy should not

be actively pursued! Having said this, it is legitimate to delay drawing benefits for as long as possible in order to try to provide protection for your family.

The downside of this strategy is that some pension vesting action must be taken by age 75 and passing pension assets on death after age 75 is more restrictive.

Under current legislation there are now a number of options that enable pension fund benefits to be drawn before age 75. These include Secured Pensions (Annuities), Unsecured Pension (including Income Drawdown and short term annuities) and Phased Retirement. At age 75 Alternatively Secured Pensions or Annuities are available. Each option has its merits and drawbacks.

But as an overall method of protecting wealth for one's family an alternative strategy of taking as high an income as possible, so depleting your pension fund, and gifting this income as it arises can be better in some instances than delaying taking any income. This is because money passed outside of a pension scheme can be used freely by the recipient whereas money passed within a pension scheme still needs to be extracted by the recipient.

You should note that all circumstances are different and there is no guarantee that a particular strategy will prove to be the most advantageous. In particular, whether death occurs before or after pension vesting has a major impact on the success or otherwise of legacy planning.

If one of your main objectives is to protect your pension funds to provide a legacy for your family, it is essential that this planning is done in conjunction with your other assets and investments.

Gordon Bowden has recently joined Mercer & Hole as a Financial Services Manager. He has extensive experience in all aspects of investment and financial planning having previously operated in the Private Banking Sector.

Northern Rock - the restructuring challenge



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I first started posting about Northern Rock on insolvencyblog.com in mid-September, contrasting illiquidity and insolvency. By November, BBC Radio was asking me to explain the potential impact of administration on depositors/borrowers, employees, shareholders and the taxpayer. (The answers are not much, job losses, worthless shares and "should be ok if the Treasury got the security for the loans and guarantees right".)

A New Year, a new phase, and a blog post revealing Alistair Darling's plans for reform of the law on insolvent banks prompted BBC TV to ask me about the potential impact of nationalisation of Northern Rock on the same groups. (Not dissimilar to administration, but nationalisation should destroy less value, jobs might be a bit safer and there may be something for shareholders.)

To examine where we are now - and it is a fast moving phase with change happening between my writing and your reading - remember where this all started: the credit crunch. Banks were not lending on the wholesale markets, hence Northern Rock's illiquidity, emergency funding from the Bank of England, the run on the bank and the Government guaranteeing depositors.

By mid-January nationalisation looked likely as the Virgin and Olivant private sector bids seemed unable to arrange funding. Then, in steps the Government with a Goldman Sachs plan to securitise Northern Rock's mortgages and issue gilt-edged bonds.

Commentators have suggested that the markets would not be keen to take up £30 billion or more of sterling paper, even over the several months it would take to put in place. Also, one cannot help thinking that the Goldman Sachs plan is redolent of the collateralised debt obligations (CDOs) and structured investment vehicles (SIVs) at the heart of the credit crunch. What if the Government goes the way of the bond insurers it would be standing in place of, many of whose ratings risk being downgraded with some looking likely to fail?

The funding scheme might work, but Northern Rock remains a more challenging restructuring than most, not only because of its massive liquidity requirement, but also because it has become the most politically sensitive restructuring for decades. Can the Government afford nationalisation, politically? Administration carries an even heavier price. And even if Northern Rock is sold to a private bidder, the deal and its funding will be under so many microscopes that any residual taxpayer risk will be identified and trumpeted in the media.

The Northern Rock problem certainly raises questions about the current regulatory regime for banks, but its core was a risky business model, mismanagement and a failure to act quickly and decisively to put things right. Risk and mismanagement happen, but when they do, stakeholders must recognise that a special skill set is required to rescue the situation and must hire the right team for the job without delay.

The Government has been the major stakeholder since guaranteeing depositors in September, but it has probably suffered political diversions from what in the business world should have been an urgent and focussed effort to transform the distressed bank. Now even the funding scheme and sale to the private sector looks like leaving mortgage default risk with the taxpayer, although perhaps this was inevitable for a period.

The Northern Rock calamity is interesting to watch - especially if you are a depositor who got their funds out - but there is beginning to be a sense that the optimum time for a solution has passed. It is a phenomenon common in restructurings, human nature being what it is with a reluctance to face unpleasant reality. The message resonates with our own experience of advising on corporate stress: get the right help early and act on it!

Why not visit our blog pages at the following web addresses...

<http://www.taxplusblog.com>

<http://www.smeplusblog.com>

<http://www.insolvencyblog.com>

<http://www.mercerhole.co.uk/news/people-blog>

<http://www.mercerhole.co.uk/news/news-blog/>

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