



MERGERS AND ACQUISITIONS

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Taxation of Cross-Border
Mergers and Acquisitions

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TAX

Jersey

Introduction

Jersey is a dependency of the British Crown and benefits from close ties to both the United Kingdom being in the same time zone and having a similar regulatory environment and business culture, and Europe. Its long tradition of political and economic stability coupled with its low tax regime and an economy dominated by financial institutions have made it an attractive location for investment.

The Island has undertaken steps to counter its tax-haven image in recent times. It was placed on the OECD white list in April 2009, and in September 2009 the International Monetary Fund issued a report in which it commented that financial sector regulation and supervision are of a high standard and comply well with international standards.

On a cautionary note, due to the limited resources available in Jersey, the government does not encourage labor-intensive inward investment controlled by non-residents, but does encourage e-commerce and knowledge based industries. There are no investment incentives other than Jersey's low tax regime and Jersey does not provide any grants, subsidies, or funds for foreign investors.

Recent Developments

With effect from 1 January 2009, Jersey introduced the Zero/Ten tax regime for companies. Under this regime, exempt companies were abolished and revised corporate income tax rates were introduced, which depend on the activities of the company. The general rate of corporate income tax is now 0 percent. The rate of corporate income tax for certain companies with permanent establishments in Jersey and regulated by the Financial Services Commission is 10 percent and the rate of tax for utility companies and companies that receive rental income or property development profits from properties in Jersey is 20 percent. The Zero/Ten regime has yet to be ratified by the EU Code of Conduct group and, in the event that this ratification is not forthcoming, further changes to Jersey's corporate tax system could be made.

In addition, in 2008 the island introduced goods and services tax (GST) to make financing public services less

dependent on direct taxation. The GST regime operates in a similar manner to the United Kingdom's VAT regime, and the standard rate of 3 percent has been set for three years.

Finally, over the past two years Jersey has established Tax Information Exchange Agreements (TIEAs) with numerous countries including the United Kingdom and the United States. These agreements, which apply to all types of taxation, are based on the OECD model and have increased Jersey's reputation as a well-regulated jurisdiction with a commitment to transparency and an effective anti-money laundering environment

Asset Purchase or Share Purchase

A purchase of shares is the more common form of acquisition in Jersey, because there is no capital gains tax in Jersey on the disposal of shares. That said, from a tax perspective, there are also no capital gains consequences to a company on the disposal of its assets, although the potential recapture of capital allowances and taxation on the extraction of sales proceeds might make an asset acquisition less attractive to the seller. Since most companies pay tax at 0 percent, this may not be relevant in every case.

Purchase of Assets

The purchase of assets may give rise to an increase in the base cost of those assets for capital allowances purposes, although this increase is likely to affect the seller, because a recapture of prior allowances will be applied. There is no capital gains tax in Jersey, so the seller can dispose of inherent goodwill without direct tax consequences, although this means that the purchaser will not receive any tax relief for purchased goodwill. In addition, historical tax liabilities generally remain with the company and are not transferred with the assets.

Purchase Price

For tax purposes, the consideration paid will be apportioned on a reasonable basis between the assets acquired. The purchase agreement should specify the allocation and this will normally be acceptable for tax purposes, provided there is a commercial rationale behind the apportionment. There are no specific statutory rules that affect how the purchase

consideration is allocated, although, in accordance with generally accepted accounting principles (GAAP) stock would normally be valued at the lower of cost and market value. Jersey does not have its own GAAP regulation so companies can choose to report under other GAAP regulations such as those of the United Kingdom or United States.

Goodwill

Any goodwill generated on acquisition is held on the balance sheet as an asset. No tax relief is available for the subsequent amortization of the asset to the income and expenditure account.

Depreciation

For tax purposes, no deduction for depreciation charges is allowed. Instead, tax relief is given for the cost of plant and machinery used in the provision of the trade at a specified rate by means of capital allowances. Expenditure on, and disposal receipts arising from, plant and machinery are pooled and a capital allowance of 25 percent per year on a reducing balance basis is given against taxable profits. A special allowance rate of 10 percent per year is allowed for horticultural greenhouses. Capital allowances are not available for expenditure on premises, such as industrial buildings, shops, hotels, and offices.

Tax Attributes

Tax losses and capital allowance pools in the target company remain with the company or are extinguished. They can only be used to relieve profits of the trade of the target company after the transaction. They cannot be transferred to the purchaser.

Goods and Services Tax (GST)

Historically Jersey has not imposed an indirect tax on the supply of goods and services. However, since May 2008 a GST regime has been in place which is similar to the United Kingdom's VAT system, and which could apply to a transfer of trade and assets. The standard rate of GST is 3 percent and it must be charged on the supply of goods and services in Jersey, which relate to a trade carried on by a taxable person. Some types of supply, such as housing and medical prescriptions, have a GST rate of 0 percent. Others, including certain financial services, postal services, and medical supplies, are exempt.

The sale of assets of a GST register-able business is subject to GST at the standard rate. However, the transfer of a business as a going concern is outside the scope of the charge to GST, provided certain conditions

are met. These conditions include no significant break in trading, the assets are used by the purchaser with the intention of carrying on the same, or similar kind of business as the seller and the assets are sold as part of the transfer of a business as a going concern. There is no specified quantum of assets which must be sold to meet the going concern standard.

Certain types of business in Jersey within the finance sector can apply for International Service Entity status, which means that they will be outside the scope of GST. These companies are generally deposit takers, or trust or fund services businesses and the majority of their business is not the provision of goods and services to Jersey residents.

Transfer Taxes

Stamp duty of 0.5 percent is payable on Jersey land transactions up to the value of GBP 50,000. For land transactions of more than GBP 50,000 scale rates apply up to a maximum of 3 percent. There was previously no stamp duty on the sale of shares in a company which owns Jersey land, but the Taxation (Land Transactions) (Jersey) Law applied from 1 January 2010, which treats the sale of shares in a company which holds land in the same way as a land transaction.

Purchase of Shares

As there is no capital gains tax in Jersey, acquisitions of shares are common. The purchase of a target company's shares does not result in an increase in the base cost of the company's underlying assets. It is also possible to acquire shares in a Jersey company through a public takeover offer, provided the shares of the target company are traded on a stock exchange in the United Kingdom, Channel Islands, or Isle of Man or the company is public, or considered to be so.

There is no exchange control in Jersey. Jersey companies may be freely incorporated with a share capital denominated in any currency and there are no restrictions on inward or outward investment, or on the repatriation of dividends, interest, and profits.

Tax Indemnities and Warranties

When the shares in a company are purchased, the purchaser takes over the company's history, including all related liabilities, known and contingent. Accordingly, the sale and purchase agreement would normally include extensive tax warranties and tax indemnities. The tax indemnity would set out the procedure for dealing with tax liabilities (both known and those subsequently arising), together with details of whose responsibility it is to prepare and agree the company's

tax returns with the comptroller, including how resolution of any disputes will be undertaken. A due diligence exercise initiated by the purchaser would include a review of the target's tax affairs to understand the extent of any outstanding tax liabilities. In this respect, it is important to note that since the introduction of Zero/Ten, certain Jersey resident shareholders are assessed on a deemed dividend (see Crystallization of Tax Charges section later in the chapter) and the company has an obligation to report this deemed dividend to the Comptroller of Tax. The due diligence exercise would need to ascertain whether this had been done.

Tax Losses

All existing tax losses will transfer with the acquired company and can generally be offset against the future profits of that company provided the trade does not change and other conditions are met. Brought-forward losses cannot be offset against the profits of other companies in the group. The acquisition agreement should indicate whether the purchaser or the seller has the right to use the target's pre-acquisition tax losses and whether there is to be any payment for the use of pre-acquisition tax losses by the purchaser,

Crystallization of Tax Charges

From 1 January 2009 new Jersey legislation imputes an annual taxable deemed dividend to Jersey resident individual shareholders who have a direct or indirect beneficial shareholding of more than 2 percent in a Jersey company. The company is deemed to have distributed 60 percent of its taxable profits, notwithstanding the level actually distributed. On certain trigger events, a final deemed dividend is calculated, based on the taxable profits accumulated, less the amount of any actual and deemed interim dividends. The sale of a company triggers a final deemed dividend as the Jersey resident individual's shareholding will cease to be greater than 2 percent. It should be noted that the company is required to administer the deemed dividend rules.

There is no capital gains tax in Jersey and, therefore, no exit charges will arise on gains inherent in the business assets of the acquired company on change in ownership.

Pre-Sale Dividend

A pre-sale dividend is not common tax planning in Jersey. This is because the dividend would create an income tax liability for Jersey resident sellers, whereas,

since there is no capital gains tax in Jersey, no tax charge would arise on gains on the disposal of shares.

Transfer Taxes

There is no stamp duty payable on the issue or transfer of shares in a Jersey company.

Tax Clearances

No specific clearances are required for the acquisition of shares. However, if the transaction is complicated, it is advisable to seek clearance in advance from the Comptroller of Tax.

Choice of Acquisition Vehicle

Several potential acquisition vehicles are available to a foreign purchaser, and tax factors will impact the decision. There is no capital duty on the introduction of capital to a Jersey company.

Local Holding Company

A company is regarded as being resident in Jersey if it is incorporated in Jersey, or if it is incorporated abroad but its business is managed and controlled in Jersey. However, a company incorporated in Jersey will not be tax-resident in Jersey if it is managed and controlled in another country, is tax resident in that country, and the highest rate at which any company may be taxed in that country is at least 20 percent. All Jersey resident limited companies are subject to income tax on their worldwide income.

A Jersey resident holding company will typically be subject to tax at 0 percent, unless it directly carries on certain financial service, utility or rental businesses. Accordingly, while for tax purposes interest costs associated with the acquisition may be deducted, this may be of little benefit if the company is liable to tax at 0 percent. It is important to note, that tax losses arising to a company taxed at 0 percent, cannot be used to offset profits arising to a company taxed at 10 percent or 20 percent under the group relief provisions.

Foreign Parent Company

The foreign purchaser may make the acquisition itself. This method of acquisition does not affect the Jersey company's tax position, although it should be noted that no withholding tax is levied on dividends or interest paid to non-residents.

Non-Resident Intermediate Holding Company

If the foreign country taxes capital gains and dividends received from overseas, an intermediate holding company resident in another territory could be used to defer this tax. It should be noted that, unlike the U.K.,

Jersey lacks a network of double tax treaties and thus has no treaty shopping provisions, which would seek to restrict the ability to structure a deal in this way solely to obtain tax benefits.

Local Branch

As an alternative to the direct acquisition of the target's trade and assets, a foreign purchaser may structure the acquisition through a Jersey branch. The Jersey branch will be subject to Jersey corporate income tax at the appropriate rate, depending on its activities. Jersey does not impose additional taxes on branch profits remitted to an overseas head office. If the Jersey operation is expected to make losses initially, then a branch may be advantageous, since there could be a benefit available to the extent that the head office country's tax regime allows consolidation of losses with the profits of the head office.

Joint Ventures

Joint ventures can be established in Jersey through the joint venture partners either holding shares in a Jersey company or participating in a Jersey partnership (the Jersey law governing General Partnerships is similar to English partnership law). The use of a general partnership could enable the joint venture partners access to initial tax losses, which could then be offset against other income, whereas the tax losses arising to a company cannot be used by the joint venture partners. However, the liability of each partner in the general partnership would be unlimited and, therefore, there are non-tax considerations that need to be addressed before the structure of a joint venture arrangement is determined.

Limited partnership structures are also available in Jersey. In a limited partnership the partners are assessed individually on their partnership income, with non-resident partners taxable in Jersey on their Jersey income, and Jersey resident partners on their worldwide partnership income.

Choice of Acquisition Funding

A purchaser using a Jersey acquisition vehicle to carry out an acquisition for cash will need to consider whether to fund the vehicle with debt or equity, or a hybrid instrument which combines the characteristics of debt and equity.

Debt

The principal advantage of debt is the potential tax deduction for interest costs and expenses, such as bank fees, in computing trading profits for tax purposes, as the payment of a dividend does not give rise to a tax

deduction. However, to minimize the cost of the debt there must be sufficient taxable profits against which these expenses can be offset. As the standard rate of tax for a holding company or a trading company, with the exception of certain activities, in Jersey is 0 percent there may be no profits which are suitable for relief and, therefore, the resulting tax losses would only be available for carrying forward and offsetting against future profits of the Jersey borrower, if any. Furthermore, in determining whether sufficient taxable profits exist, losses created in the debtor company can only be group-relieved to other group companies if they are subject to the same rate of tax, and in any case the ability to group-relieve losses is not relevant between group companies which are taxed at 0 percent.

Deductibility of Interest

Under the new Zero/Ten regime, no Jersey company is obliged to make any deduction on account of any Jersey tax from any interest payments made by the Jersey company.

Interest payments made by a Jersey company on loans taken out to acquire a trading or a controlling interest in a Jersey company are treated as deductible as trading or management expenses for tax purposes. If capital is withdrawn by the person paying interest, this is treated as if the amount withdrawn had been used to pay off all or part of the loan and an amount equal to the interest on that portion of the loan is deducted from the eligible interest.

There are no specific transfer pricing or thin-capitalization rules in Jersey that restrict the tax deductibility of interest. However, the arm's length principle applies and general anti-avoidance legislation enables the Comptroller to use his/her discretion when reviewing the commercial basis of transactions

Withholding Tax on Debt and Methods to Reduce or Eliminate

There is no withholding tax on interest payments in Jersey.

Checklist for Debt Funding

Although Jersey does not have specific transfer pricing and thin-capitalization legislation, inter-company debt should be structured to ensure that it satisfies the arm's-length principle.

- Consider whether the level of profits would enable tax relief for interest payments to be effective and at what rate.

- It is possible that a tax deduction may be available at higher rates in other territories.
- Group relief is not available between group companies whose profits are taxed at different rates, so if interest cannot be offset immediately; it can only be carried forward.

Equity

- A purchaser may use equity to fund its acquisition, possibly by issuing shares to the seller in satisfaction of the consideration or by raising funds through a seller placing. The seller may also wish to capitalize the target post-acquisition.
- There is no stamp duty on the issue or transfer of shares in a Jersey company.
- Equity offers less flexibility if the parent company subsequently wishes to recover the funds it has injected, but may be more appropriate if the target is loss-making or if there is no tax deduction available for interest costs in Jersey.

Hybrids

Hybrid structures are unlikely to be of relevance in Jersey, as there is no capital gains tax. The deductibility of interest may be a concern, however. As these structures are being restricted specialist advice should be sought as to their tax efficiency.

Discounted Securities

The tax treatment of securities issued at a discount follows the accounting treatment, so that the issuer should be able to obtain a tax deduction for the discount over the life of the security, again subject to the rate of tax at which the tax deduction is available. There is no Jersey legislation which provides for the deferral of the discount accruing where the borrower and lender are connected parties.

Deferred Settlement

Sometimes an acquisition agreement involves an element of deferred consideration derived from the future performance of the business. In Jersey, as there is no capital gains tax, any gain arising from this unknown sum is not subject to tax.

Other Considerations

Concerns of the Seller

The tax position of the seller will be a factor in the structure of an acquisition transaction. As there is no capital gains tax in Jersey it is likely that the seller would want a capital gain to arise on sale, rather than, for

example, extracting some of the value of the target through a pre-sale dividend which would give rise to taxable income.

Company Law and Accounting

The Companies (Jersey) Law 1991 (revised 1 January 2009) prescribes how Jersey companies may be formed, operated, re-organized, and dissolved. The law allows for the formation of a number of different types of companies, such as no par value companies and cell companies. Jersey company law provides considerable flexibility in, for example, determining how companies may be re-organized. The law allows two or more companies to merge provided none of them has unlimited shares or guarantor members.

As for mergers and acquisitions, a business combination, which, under IFRS, is defined as the bringing together of separate entities or businesses into one reporting entity, may be classified as either a merger or an acquisition. In essence, a combination is regarded as a merger when it effects a pooling of business interests (that is, where one company's equity is exchanged for equity in another company), or shares in a newly incorporated company are issued to the merging companies' shareholders in exchange for the equity, with both sides receiving little or no consideration in the form of cash or other assets.

Accounting standards predominantly determine the accounting treatment of a business combination. In general, most combinations are accounted for as acquisitions; merger accounting only being applied in certain circumstances. Merger accounting is not allowed under IFRS; all business combinations must be accounted for as acquisitions. The relevant U.K. accounting standards restrict merger accounting to (and make it obligatory for) a very small number of genuine mergers and group reorganizations not involving minority interests. Genuine mergers are those in which the shareholders come together in a partnership for the mutual sharing of the risks and rewards of the combined entity, and in which no party to the combination in substance obtains control over any other, or is otherwise seen to be dominant in any way. Numerous detailed conditions must be met.

One of the main practical distinctions between acquisition accounting and merger accounting is that acquisition accounting may give rise to goodwill. The net assets acquired are brought onto the consolidated balance sheet at their fair values, and goodwill arises to the extent that the consideration given exceeds the aggregate of these values. As long as IFRS is not

adopted or incorporated into U.K. GAAP, the goodwill is then amortized through the profit and loss account over its useful economic life. Acquisition accounting principles also apply to purchases of trade and assets with any goodwill and fair value adjustments appearing on the acquirer's own balance sheet. In merger accounting, goodwill does not arise, as the acquirer and the seller are treated as though they had operated in combination since incorporation; adjustments are made to the value of the acquired net assets only to the extent that this is necessary to bring accounting policies into line.

Another important feature of Jersey company law concerns the ability to pay dividends. Distributions of profit may be made out of any account of the company, other than the capital redemption reserve or the nominal capital account. Directors are required to make a statement regarding the ongoing solvency of the Company for a period of at least 12 months after the distribution.

Finally, a common issue on transaction structuring is the provision concerning financial assistance. Prior to 1 January 2009, it was illegal under Jersey company law for a Jersey company or any of its Jersey subsidiaries to give financial assistance directly or indirectly for the purpose of the acquisition of its own shares. This law has now been repealed.

Group Relief/Consolidation

From 1 January 2009, the Zero/Ten regime formally introduced group relief provisions to apply to companies subject to tax at 0 percent and 10 percent. The provisions only allow losses to be offset from one 0 percent company to another and from one 10 percent company to another. Thus the position will not be straightforward for groups that comprise trading companies taxed at different rates. A company must own 51 percent of its subsidiary to be eligible for group relief.

Transfer Pricing

There is no formal legislation governing transfer pricing, related party transactions or thin-capitalization. However, the arm's length principle applies and general anti-avoidance legislation enables the comptroller to use his/her discretion when reviewing the commercial basis of transactions.

Dual Residency

The rules surrounding dual residency were updated in 2007 in Jersey and provide that, subject to certain conditions, a Jersey company managed and controlled

outside Jersey, for instance in the United Kingdom, would be treated as being solely tax-resident in the United Kingdom. There is no advantage or disadvantage to a company being dual-resident under the Jersey tax regime.

Foreign Investments of a Local Target Company

Jersey does not have controlled foreign companies (CFC) legislation. However, it is a low tax jurisdiction so the CFC legislation of the territory of the investing company may be applicable.

Mergers

It is possible for two Jersey incorporated companies to merge into a single entity; however, it is not currently possible for a foreign company to merge with a Jersey company. When two companies merge the merged company will assume the tax liabilities of both the merging companies.

Comparison of Asset and Share Purchases

Advantages of Asset Purchases

- It is possible to acquire only part of a business.
- A step up in the base cost of plant and machinery assets is possible.
- Capital allowances are available on the relevant part of the purchase price.
- A deduction is available for trading stock purchased.
- There is no capital gains tax payable by the seller on purchase of capital assets such as property and goodwill.
- The historical liabilities of the company are not inherited.
- No GST is charged on a transfer of a going concern.

Disadvantages of Asset Purchases

- GST might need to be paid at 3 percent.
- Tax losses remain with the seller and cannot be used by the purchaser.
- It may be necessary to renegotiate supply, employment and technology agreements, or to renew licenses.
- A higher outlay may be required if no liabilities are included in the purchase.

- No tax relief is available for the amortization of goodwill.
- It may be unattractive to the seller, given that a disposal of shares would be tax free, thereby increasing the price.
- Higher transfer taxes usually arise.

Advantages of Share Purchases

- Tax losses remain available to be used against profits of the same trade.
- No GST on a transfer of shares.
- No stamp duty is payable on a transfer of shares.
- Capital outlay may be lower as net assets are acquired.
- As there is no capital gains tax in Jersey, it is likely to be more attractive to the seller.
- There is less need to renegotiate contractual arrangements, unless change of control provisions exist.

Disadvantages of Share Purchases

- The buyer effectively acquires all the history of the company and becomes liable for any claims or previous liabilities of the company, including tax.
- The purchase price cannot be deducted for tax purposes.
- Acquired losses can only be used to relieve profits of the same trade and cannot be group relieved.

Double Taxation

Jersey has double taxation arrangements in place with the United Kingdom and Guernsey, and a limited agreement with France relating to income and profits from shipping and aircraft.

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