



COVID-19:
What's next and
beyond for tax?

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COVID-19: Next and Beyond

Companies continue to address the immediate priorities in dealing with COVID-19, making use of government support measures where appropriate.

However, they are now looking ahead to the future:

- ▶ Exploring the next – in the short term what needs to be considered to preserve value and embrace the recovery?
- ▶ Imagining the beyond – what will help to create long-term value and re-frame future business for the ‘new normal’?

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1.

Group structuring

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1a. Capital and ownership structure: funding

Key: ■ Next ■ Beyond

COVID-19 is likely to reduce the earnings before interest, tax, depreciation and amortization (EBITDA) levels of most businesses in the short and medium term, which means rules that benchmark interest deductions against EBITDA are likely to bite.

Private Equity (PE) backed businesses, which tend to be more highly-leveraged, will be disproportionately affected.

At the same time lots of businesses will be seeking new sources of finance, not least to meet their working capital requirements in markets/supply chains of low liquidity.

Businesses need to be thinking about their capital structure and whether it is fit for purpose in the current conditions. Changes to capital structure may be required but careful consideration should be given to ensure the tax impacts are fully understood.

Cash repatriation

Prior to moving significant sums around a group structure, consideration should be given to:

- ▶ Distributable reserves restrictions
- ▶ Exchange control restrictions
- ▶ Withholding taxes (WHT)
- ▶ The impact of changes to the intercompany debt structure on the availability of future tax deductions
- ▶ Whether a centralised cash pooling arrangement may be appropriate

Obtaining value for losses and other tax attributes generated during COVID-19

Exit-planning should include strategies for obtaining maximum value for these attributes on sale.

The business/transfer pricing model should be reviewed to consider the territories where taxable profits and losses are being generated and whether one off or lasting changes to markets should result in changes.

Provision of additional funding

Prima facie, interest deductions on third party bank debt are likely to be greater than on shareholder debt.

Some investors preference may be for equity funding over debt funding due to the tax benefits for them.

Shareholder debt may better facilitate cash extraction for the fund.

Changes to existing debt

Advice should be sought to quantify the tax charge, if any, that could arise on a buyback, capitalisation, or waiver of existing debt and to identify the most efficient purchasing entity in the case of a buyback.

Divestment

The transaction steps for any proposed disposal/divestment should be carefully considered from a tax perspective prior to execution including cash repatriation of proceeds.

Impact on interest deductions

The impact of rules that benchmark interest deductions against EBITDA should be reassessed using COVID-19 affected EBITDA levels. On the plus side, the US for example have temporarily relaxed their limitations on interest deductions.

Thin capitalisation and anti-hybrid rules will impact related party debt, whereas debt cap restrictions will impact third party debt as well. Interest on bank debt should not be assumed to be allowable.

Legal practicalities

Debt covenants with third parties will need to be assessed since re-organisations of capital/debt or significant extraction of value from material companies may require lender or other consents.

Characterisation of debt or interest payments often follows legal form and legal arrangements need to be documented carefully to avoid challenge from HMRC or other third parties.

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1b. Capital and ownership structure: shareholder value

Key: ■ Next ■ Beyond

The impact of COVID-19 may cause business owners and shareholders to revisit their ownership structures.

Any changes to such structures, business models and management incentive plans will need to be assessed from a tax perspective including how this may impact on exit or succession planning.

We have already seen considerable government intervention with significant changes to tax legislation and rules and more is likely. Businesses and individuals will need to ensure that they remain up to date with such changes and how that affects them and their business models/ownership structures.

The mechanisms that drive existing remuneration and distributions may need to be reviewed. Any reworking will need to factor in the impacted business performance, any changes in tax legislation and potential changes in the business ownership structure.

Exits and succession

Prior to exiting a business (either fully on sale or upon succession), attention is needed to ensure:

- ▶ That the tax consequences of changes to the business model are considered (such as qualifying for Substantial Shareholding Exemption (SSE), Business Property Relief (BPR), Entrepreneurs' Relief (ER) etc.)
- ▶ Any management incentive plans and earn outs, existing or to be implemented, should be reviewed to consider the impact of the current situation with regard to performance and retention. Do they continue to drive the required behaviour?

Shareholders and management

Advice should be obtained by the shareholders and management upon any distribution received or proposed by the company to ascertain the correct tax treatment.

Those shareholders who are not usually UK resident in the UK but have spent time here should seek advice on:

- ▶ The number of days spent in the UK and the related tax consequences.

- ▶ How the number of days spent in the UK may trigger domicile issues in the context of Inheritance Tax (IHT), Capital Gains Tax (CGT) and Income Tax.

Safeguarding assets

Assets held within structures, both trade related and investment based, should be reviewed to ensure:

- ▶ Future financial security against adverse business performance.
- ▶ Improved efficiency from a tax perspective
- ▶ Maximum availability of tax reliefs such as BPR, ER etc

Care should also be taken to consider other taxes that may be involved, such as VAT, stamp duty/stamp duty land tax.

Changes to tax legislation

We are likely to continue to see significant changes to tax legislation going forward.

Issues to consider would include:

- ▶ Whether any sales/revenue taxes are due in other jurisdictions and any resulting compliance requirements.

- ▶ Digital services taxes that may be payable for online services provided in the customer's jurisdiction, and how these interact with the UK tax position.
- ▶ Overseas permanent establishment and tax residency aspects.
- ▶ Changes to tax incentives, such as R&D and grants.
- ▶ Impact on rules regarding individual tax residency and domicile.
- ▶ Increased scrutiny in the areas of tax transparency and governance.

Alternative structures

Not all businesses will or should be held in a corporate wrapper.

Consideration should be given to alternative arrangements such as:

- ▶ General partnerships
- ▶ Limited Liability Partnerships
- ▶ Trusts (both business and non-business related)
- ▶ Unlimited companies
- ▶ Advice should be sought before implementing any of the above.

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1c. Operating structure: cash flow considerations

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There are a number of cash flow efficiencies and optimisations that may be applicable to businesses in the current business climate.

Each of these efficiencies and optimisations may have their own specific conditions that need to be met.

VAT cash flow optimisation

- ▶ The usual trigger for UK input VAT recovery is determined by the time of supply rules. Depending on whether the costs relate to goods or services, the time of supply may be the earlier of payment, invoice, completion of the service or delivery of the goods. With that in mind, businesses may wish to accelerate VAT refunds through active management of processes.
 - ▶ Further, businesses may wish to accelerate UK VAT refunds through active management of controversy/reviews if they consider they have been overly prudent in accounting for output VAT or blocking input VAT recovery.
 - ▶ Where businesses have suffered foreign VAT because of a local place of supply such as on hotels or taxable land-based supplies, they should pursue recovery of that foreign VAT.
- (and other conditions met), the business may wish to benefit from actively seeking bad debt relief.
- ▶ Businesses may wish to optimise UK VAT grouping structures in order to achieve efficiencies in VAT accounting time as well as the timing difference between accounting for output VAT in one entity and recovery of input VAT in another.
 - ▶ Unlike VAT in most cases, customs duties are a hard cost for businesses and so it is vital to utilise Free Trade Agreements to realise available preference.
 - ▶ Now is a critical time to identify suboptimal classifications and valuations and seek refunds.
 - ▶ Utilise Customs Special Procedures.

VAT reductions

- ▶ If a business has accounted for UK output VAT on a supply made to a customer but the customer has not paid and six months have elapsed

Make use of innovation incentives

Monitor applicable government grants and economic incentives which are likely later this year. Review R&D claims to make sure all eligible costs are identified.

Reflecting cash value for losses and other tax attributes

- ▶ Consideration should be given to carrying back losses to profitable periods to generate cash repayments. There may be increased flexibility to do this (the US for example).
- ▶ Update calculations of tax instalment payments including for changes to business/transfer pricing model (locations of future income and deduction of transition/recovery costs).

Practicalities

- ▶ For VAT grouping a number of forms need to be completed and conditions met in order to achieve grouping. If there are partial exemption issues these should be fully considered.
- ▶ VAT bad debt relief can be claimed subject to a number of conditions but a period of six months must have elapsed.
- ▶ For direct taxes businesses should contact HMRC and look to submit amended returns and claim refunds of overpayments as soon as possible (recognising that tax authority resources may be stretched at this time).

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2a. Supply chain: tax implications of new arrangements

Key: ■ Next ■ Beyond

COVID-19 is likely to result in many groups adapting their supply chains to be better placed to deal with the new challenges that they face.

There are a number of issues to be considered in order that the new model is optimised as far as possible and potential tax and legal risks are mitigated:

- 1. Liquidity:** Changing cash management needs and risk profiles will alter groups' treasury functions, capital structure and financing flows.
- 2. People:** New working arrangements may lead to new tax obligations such as taxable permanent establishments in different tax jurisdictions.
- 3. Operations:** Contractual and product flows will adapt to the new environment triggering changes across transfer pricing, customs duties, withholding tax and VAT.

Liquidity

- ▶ Changes to the cash management operations of the business are likely to lead to more centralised decision making and control around the holding of capital. This will help businesses improve their ability to meet their cash needs effectively and manage long term financial impacts to ensure uninterrupted operations.
- ▶ The credit risk profile of the multinational group and constituent entities can be expected to be impacted.
- ▶ Intragroup funding policy and cash pooling arrangements will need to be updated.
- ▶ This will need a reassessment of the capital structure and intercompany financing flows in the business to ensure the level of interest charge in each case is appropriate for the new supply chain and that the tax implications have been fully considered.

People

- ▶ Changes in the location of staff and working arrangements may require individuals to be transferred between group entities or to recognise that

entities are now undertaking activities outside their home jurisdiction.

- ▶ This will lead to changes in contract and product flows, and the decision making structure of the business.
- ▶ The tax profile, intercompany arrangements, and tax compliance obligations will need to be reviewed; in particular any risk of creating tax obligations in new territories through permanent establishments of group entities should be assessed.

Operations

- ▶ Changes in raw material and intermediate supply risk, reduced logistics options and shipping capacity, changing cost structures, location of production facilities, availability of labour and other factors are likely to significantly alter the operational profile of many businesses.
- ▶ There will be an impact on route to market from changes to patterns of consumer demand, restrictions on exports and access to certain markets, changing channel distribution channel choice, and amendments to contractual terms and conditions.
- ▶ Changes to the command and control structure of the business may be made to allow greater agility at the global/

regional/functional level. This will change reporting lines and how/where decisions are made.

- ▶ This will lead to significant changes in the contractual and product flows within a group, the management and decision making structure, the characterisation of the contribution of different entities, the risk profile and potential for profits/losses in different territories.
- ▶ These changes will trigger implications on the dutiable value where there is movement of goods. Consideration should be given as to where costs such as import duties will be borne in the supply chain.
- ▶ Transfer pricing adjustments including regular and ad hoc adjustments will have impact on a company's customs position in individual countries. Customs processes need to be managed at central and local level.
- ▶ The application of Free Trade Agreements (FTAs) may need to be reviewed as a result of changes to the operating model. The design of future models can take into consideration the effective use of FTAs.
- ▶ The transfer pricing model, customs duty, WHT, and VAT implications will all need to be reconsidered taking into account the changes that have been made to the group's operations.

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2b. Supply chain: legal and practical implications

Key: ■ Next ■ Beyond

COVID-19 is likely to result in many groups adapting their supply chains to be better placed to deal with the new challenges that they face.

There are a number of issues to be considered in order that the new model is optimised as far as possible and potential tax and legal risks are mitigated:

- 4. **Legal:** Changes will be needed to contractual frameworks and regulatory compliance throughout the group.
- 5. **Practical implications:** Given the potential for significant changes, it will be important both to consider transitional issues and document decisions taken.

Legal implications

- ▶ There will be a requirement for new, or changes to current, corporate structures to support supply chain remodelling.
- ▶ New contracts will need to be implemented, either internally to support transfer pricing changes, or with new third party supply chain participants.
- ▶ Consideration on the impact of existing contractual obligations and the ability to flex supply chain such as exclusivity with certain suppliers; volume commitments and minimum purchase obligations; take or pay; restrictive notice periods.
- ▶ There may be a need for large scale contract review of current contracting arrangements to assess exposure to future risk, ability to exit and any associated penalties/compensation.
- ▶ Where changes are required, it will be important to consider how to best achieve consistent back to back terms and identify gaps in terms between pre and post-COVID-19 arrangements.
- ▶ There is the potential for an increase in supply chain participants to drive a requirement for clearer contract

lifecycle management and database tools.

- ▶ Consideration of the regulatory framework in any new market and the ability of new suppliers to meet regulatory standards (such as product safety; data protection; export sanctions).
- ▶ Other matters of regulatory compliance should be considered – antitrust; anti-bribery laws; modern slavery assessments; potential for new longer term regulation around government ability to access supply chain information (possibly sector specific – food retail/healthcare).
- ▶ Adaptation may be required to new market 'norms' in negotiation including more protective positions on liability and risk allocation, payment terms, force majeure, hardship provisions, changes to KPIs, etc.

Practical implications

- ▶ There may be significant changes to the supply chain of the business due to changes in contractual and product flows, financing arrangements, employee location and decision making systems and processes.

- ▶ This means that the operating model of the business will need to be re-evaluated and consideration given on how to align the profits of the business with the location of value creation.
- ▶ The transfer pricing model will need to be updated (including goods, services, interest and royalties) and the tax leakage from WHT, customs duties and VAT considered.
- ▶ Whether transfer pricing arrangements are subject to major changes, slight adjustments or left unchanged in 2020, the support for this decision will need to be carefully documented.
- ▶ The existing legal framework and contractual arrangements should be examined.
- ▶ Tax, legal and regulatory compliance obligations will need to be re-examined to ensure that they are being met.
- ▶ Transition issues will also need to be considered to mitigate the risk of unexpected costs from implementing the new structure.

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3a. Digitisation: the push to new operating models

Key: ■ Next ■ Beyond

Restriction of physical movement for consumers and the workforce has magnified the role of digital technology to bridge the gap.

Areas where digital technologies and operating models are used to manage disruption and increase resilience:

1. Shifting to/increasing customer engagement and sales through online channels.
2. Building ecosystems with third parties to increase collaboration within and across supply chains.
3. Use of digital technology to improve visibility of operations/ inventory location and central data control tower and localising parts of the supply chain.
4. De-risking business by switching from owning fixed assets to paying for usage – developing concept of 'servitisation'.

External factors encouraging change

Loss of access to most physical stores during the lockdown and restriction of movement more generally is accelerating considerations of new business models as well as reviews of companies' interactions and transactions with customers, suppliers and partners.

New business models

- ▶ There is an acceleration/strengthening of collaboration within and across supply chains and building of ecosystems to increase resilience of trading arrangements.
- ▶ De-risking of the business by buying services rather products e.g. servitisation offerings on subscription (or other) basis.

Scope for operational change with customers and suppliers

- ▶ A shift to/increase of sales activity on e-commerce platforms – businesses are turning to using third party e-commerce infrastructure in the short term. In the medium term, the e-commerce capability would be either built or acquired.
- ▶ An increase in Direct-to-Consumer engagements through online social media and other on-line channels to support brand message and value, build/maintain customer networks and brand loyalty in the medium and long run.
- ▶ Increased use of analytics though centralising capability in data control centers to increase visibility and agility of decision making across the value chain including customer insights, operational efficiency, customisation of offerings, procurement etc.
- ▶ Operational efficiency improvement of fixed assets utilisation and costs through the use of Internet of Things (IoT), virtual reality/augmented reality (VR/AR), artificial intelligence, and machine learning.

- ▶ Increased tracing- and-tracking of inventory and agility of distribution functions through the use of IoT/ sensors, and blockchain.

Practicalities

Change in remit is expected for operating models, depending on the industries and functions:

- ▶ The B2C digital operating models are likely to have regional rather than global remit.
- ▶ Industrial/B2B digital operating models could have either global/ regional remit.
- ▶ Digital is making parts of the supply chain local e.g. personalisation of offering and critical response services of offerings.

M&A – Companies are likely to acquire businesses with digital capabilities to accelerate the process – consider touchpoints between acquired and acquiring business versus integration of the acquired business depending on the digital maturity of the acquiring business.

Workforce – Employment models likely to change with increased digitisation.

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3b. Digitisation: tax issues from new operating models

Key: ■ Next ■ Beyond

Introducing new business models and technology in companies will have an impact on tax compliance and reporting, some of which will be time sensitive and some not.

Having an overview of changes in the business across multi-jurisdictions and making effective decisions between record, report and advise on tax matters is critical for organisations to navigate the short term and operate in a sustainable model going forward.

Direct tax/transfer pricing considerations

- ▶ New categories of IP assets (data, copyrights, customer networks etc.) will be created which need be identified, protected and appropriately commercialised – from the start from the legal and tax/transfer pricing perspective.
- ▶ New offerings and business models will result in new service fees internally and to third parties – consider character and WHT.
- ▶ Permanent Establishments/Digital Permanent Establishments – to be considered under new business/operating models.
- ▶ Digital taxes – requires country-by-country assessment and assessment of any double taxation that may arise.
- ▶ Emergence of new digital value-creating functions and new risks e.g. cybersecurity, data protection etc. – that may lead to changes to transfer pricing arrangements within the new digital venture.
- ▶ Consider touchpoints between legacy and digital business Transfer Pricing (TP) arrangements.

Customs/tariffs/VAT considerations

- ▶ Fees for new offerings – VAT to be considered for various new services payments.
- ▶ Customs/tariffs/import VAT/VAT to be considered for goods related to e-commerce and assets/spares for servitisation offering.

Global work on digital taxation

A number of territories are considering introducing similar taxes to the digital services tax in the UK. There are differences between the various proposals and if a business is outside the scope of one country's tax this is no guide as to whether they are outside the scope of another.

Multilateral efforts to find common ground to address the tax challenges arising from digitalisation of the economy continue with a meeting of the G20/OECD Inclusive Framework on Base Erosion and Profit Shifting (BEPS) for 1-2 July 2020 in Berlin. Most governments who have introduced their own tax have indicated that they would replace that tax with whatever is agreed at a global level.

Practicalities

- ▶ Tax and TP events may be triggered as a consequence of external factors. Some of them may require action by the year end, such as TP reports, tax compliance in respect of new activities etc.
- ▶ However, making decisions on where and by which entity new technology should be acquired or investments be made or new trading/partnership arrangements be entered into needs to be considered and documented in real time.
- ▶ New technology may trigger a change in legal intra-group transfer pricing arrangements mid-year which should be preliminarily documented in real-time even if all relevant entries are only fully in place by year end.
- ▶ Forecasting additional tax charges that may arise may give the opportunity to consider passing on some of the costs to the customer where new arrangements are being agreed.

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3c. Digitisation: compliance requirements

Key: ■ Next ■ Beyond

Given government reliefs and stimulus across different countries during the pandemic, compliance reporting requirements (albeit with extensions) still stand.

Organisations may find themselves exposed to key person risk and non-compliance consequences in different jurisdictions where filings are managed in-house or by various local service providers.

Legal considerations of increased digitisation

- ▶ New corporate structures to build in-house or acquire business with digital capability/new digital business model.
- ▶ Digitally focussed policies and procedures.
- ▶ Regulation of digital business likely to increase, e.g. competition law, consumer rights, e-commerce regulation, employment law.
- ▶ Intellectual property – identification, protection, ownership/licensing rights, commercialisation strategy, source code access and escrow, and use of Open Source Software (OSS).
- ▶ New contracting arrangements requiring allocation of responsibilities, roles and risk that may differ from current operating model (i.e. responsibility for software failure or poor design; liability limits particularly for data loss). Beware of the 'digitisation gap' between the legal, commercial and technical realities. This includes:
 - use of smart contracts and blockchain
 - intra-company agreements for new TP arrangements

- purchase/leasing new equipment
- outsourcing of functions
- agile software development
- cloud, IoT, end user licence agreements (EULAs)
- data risk and opportunity – increased data privacy obligations and cyber risk, data monetisation, website compliance, data location considerations
- exiting/amending existing terms and conditions and contracts e.g. reducing bricks and mortar footprint

Continuity and future planning

- ▶ Evaluate legislative and regulatory changes for compliance in all global locations (utilise Global Stimulus Tracking tool).
- ▶ Identify any resource constraints and the need for interim support services including loan staff, CFO support services, and/or payroll.
- ▶ Assess key risk areas in compliance process – data flows and data manipulation to sources, hand-off points, and controls.

- ▶ Evaluate existing Tax, Legal and Finance outsourcing contracts to accelerate renewals or extensions to ensure continuity.
- ▶ Assess current and future tax and finance operating models and business continuity to address key person risk or prepare for long term disruptions and post-disruption recovery, including technology enablement for compliance.
- ▶ Digitisation, streamlining and/or outsourcing of business legal and/or finance function.
- ▶ Consideration of core activities and potential managed services.

Practicalities

- ▶ Understanding of the roles and responsibilities to compliance and reporting in every jurisdiction within the group.
- ▶ Identification of any governance to manage risk of exposure to non-compliance and mitigation actions.
- ▶ Assess impact assessment of any restructuring to compliance reporting requirements.

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Workforce

Enabling, protecting and refocusing people

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4. Enabling, protecting and refocusing people

Key: ■ Next ■ Beyond

The rapidly escalating challenges from the COVID-19 pandemic present critical people issues for organisations to assess and address.

We have identified five people themes that cover the iterative lifecycle of understanding and assessing the immediate situation that people are in and the movement, protection and enablement of individuals and teams as the situation evolves.

There is of course also the need to look at both the immediate and likely capability and capacity needs of your business and how these may need to dynamically change over time.

Understanding people impacts and priorities

- ▶ Understand the immediate and ongoing risk to health and life of employees.
- ▶ Identify employee impacts of changes to business operations and critical skills.
- ▶ Be clear on and protect workforce values that align with your purpose.
- ▶ Establish and align leadership capability to dynamically assess, plan, decide and communicate people strategies.
- ▶ Assess global workforce exposure and worst case scenarios.

Enabling people

- ▶ Agree alternative, inclusive and flexible ways of working.
- ▶ Assess issues with shift patterns, continuity of work, customer service and delivery.
- ▶ Review and accelerate virtual collaboration and new ways of working with tech.
- ▶ Increase engagement, communications and 'check-ins'.
- ▶ Review reward schemes and considerations.
- ▶ Appropriately tax safe working benefits.

Moving people

- ▶ Identify and support locally/globally mobile employees and their families.
- ▶ Understand the constantly changing immigration landscape and the new travel restrictions and assess the exposure and impact on employees.
- ▶ Assess impact of crisis for global business travellers.
- ▶ Determine action plan for locations, groups and individuals.
- ▶ Assess the individual, employer and business tax impacts of displaced mobile employees working remotely.

Maintaining capability and capacity

- ▶ Prepare for what might come.
- ▶ Model and adapt your workforce plans to maintain capability across your critical functions.
- ▶ Align workforce planning to longer term goals as well as short term contingency.
- ▶ Budget for shorter term costs/contingency.
- ▶ Consider alternatives for cost minimisation (including the Coronavirus Job Retention Scheme).
- ▶ Identify key roles and talent.

Protecting people

- ▶ Keep employees safe and healthy at work.
- ▶ Allow appropriate levels of flexibility for alternative working.
- ▶ Ensure employee legal rights are not compromised (e.g. pay, working hours, conditions, D&I).
- ▶ Review and reinforce workforce health provision (in-house/third party).
- ▶ Consider ongoing access to health care for displaced globally mobile employees and their families.
- ▶ Address employee questions and concerns via communication channels and hubs.

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5a. Recovery, restructuring and refinancing

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Businesses may need to right size debt in order to provide headroom to implement recovery plans and rebuild for the future.

Releasing debt has a tax impact and accessing exemptions will be key to ensure that tax leakage is not an obstacle to a successful recovery.

There are a number of exemptions in the UK that may be available to shelter gains on the release of third party and intercompany debt.

These exemptions only apply if certain conditions are satisfied. As a result, the conditions need to be carefully reviewed in light of the commercial objectives.

From the wider perspective of insolvency laws, directors should note the UK Government's announcement to suspend the application of existing wrongful trading laws, effective from 1 March 2020.

Changes to debt structure

Where a UK debt arises from the lending of money, generally the corporation tax treatment of the related accounting debits and credits should fall within the loan relationship rules. In this case, the tax treatment broadly follows the accounting treatment.

Assuming it is confirmed that the balance is a loan relationship debt then:

- ▶ Third party loan relationship
The release may be exempt if the debt is released and:
 - it is for the issuance of ordinary share capital ('debt for equity swap') or
 - it is part of a statutory insolvency arrangement or
 - it satisfies the corporate rescue exemption or
 - one of the insolvency conditions are met.
- ▶ Intercompany loan relationship
 - A release may be exempt if the debt is between companies that are connected for at least one day of the accounting period in which the release take place.
 - However, certain 'deemed releases' are not exempted under the connected company exemption.

These include where either (a) the lender acquires the rights to the loan relationship at undervalue from a connected party; or (b) where the lender and borrower become connected (e.g. through a debt for equity swap) and the lenders rights are subject to an impairment adjustment.

- That said, there are certain exceptions to the deemed release rules. These are complex and need to be assessed on a case by case basis.

- ▶ Other
 - If a taxable release is anticipated to arise, i.e. not exempt, consideration needs to be given to what tax attributes may be available to shelter this.
 - Where modifications are being made to debt, consideration needs to be given to the tax impact of this modification.

Changes to insolvency laws

- ▶ The Government has announced a three month suspension of wrongful trading laws with effect from 1 March 2020.
- ▶ Other, existing directors' duties remain in place and professional advice is recommended in cases of doubtful solvency.
- ▶ New restructuring procedures are also due to be outlined soon, aimed at giving companies more options and greater protection when in financial distress.

Practicalities

- ▶ It may not always be clear if a loan relationship exists and, therefore, if these exemptions are available.
- ▶ For third party debt, the position is generally more supportable on the basis that these debts are generally documented and obtained for a clear purpose. However, for intercompany balances, there can often be a lack of corporate history to support the balance. In this case, it may be necessary to bring the debt within the loan relationship legislation by documenting (in legally binding terms) the issuance by the debtor of a unilateral instrument representing the rights of the creditor. Similarly, any release of such debt by the creditor should appropriately be documented (typically in the form of a deed of release) together with associated corporate authorities and board resolutions. The impact of this needs to be reflected in the transaction timescale.
- ▶ There may be other accounting, legal and overseas tax (if the borrower is not tax resident in the UK) and other UK legal and tax (e.g. lawful distributions, withholding tax) implications that need to be considered.
- ▶ Obtaining advance HMRC clearance may not be possible.

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5b. The impact of insolvency within the group

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Where recovery may not be possible, or an insolvency process may be used to effect a disposal or restructuring, the interplay of insolvency law and tax law needs to be considered to ensure value is not lost.

The appointment of a UK Insolvency Practitioner (IP) over a UK company impacts the UK corporate tax accounting period(s), UK tax groupings (and beneficial exemptions that apply) and the ranking of any tax liabilities that may be payable by the company.

This is not an exhaustive list of issues but a reflection of common matters that need to be considered.

The position on the appointment of a receiver is different and not covered here.

Impact of insolvency

- ▶ The appointment of an administrator (and any subsequent cessation of trade) causes an accounting period to end for tax purposes.
- ▶ The appointment of a liquidator also causes an accounting period to end for tax purposes. However, a cessation of trade in the liquidation period does not.
- ▶ This is critical as any UK corporate tax liabilities that crystallise in the administration or liquidation tax period(s) are payable by the IP to the extent that there are floating charge realisations.
- ▶ Therefore, the IP needs to understand what taxable income/gains may arise and what shelter may be available to reduce or eliminate this.

Approach for tax

- ▶ Review tax attributes and tax base costs taking into account what is being sold (i.e. assets or shares), any clean up of debts required and other income/realisations.
- ▶ Trading losses carried forward at the date of cessation are extinguished meaning that these losses will have minimal value going forward.
- ▶ A UK Substantial Shareholding Exemption Review may be needed

to consider if any share disposal is exempt. This may also be needed if there are degrouping charges (i.e. claw backs from previous intra group transfers of chargeable assets to the target group from the vendor group).

- ▶ If a business sale is commercially preferred, there may be a tax impact of any pre sale reorganisation (e.g. hive down of the desirable business into a Newco).
- ▶ The appointment may impact the ability of the company to claim tax losses from other entities and/or benefit from intra group reliefs. This needs to be reviewed.
- ▶ Consider if there are any opportunities to reclaim overpaid taxes. In particular, where the trade has ceased, whether the company can benefit from a terminal loss relief claim to carry back losses further than normally permitted.
- ▶ If debts are to be released this may be taxable unless a specific exemption applies. The exemptions need to be reviewed on a case by case basis.
- ▶ Confirm the VAT and stamp impact of any commercial steps and/or realisations.
- ▶ Non UK taxes should be considered if applicable, together with tax residency matters if there is an appointment over a non UK incorporated entity.

Practicalities

- ▶ There may be a lack of corporate history and/or supporting tax information. As a result, taking into account the split of fixed/floating realisations, additional work may be needed to support a filing position with HMRC.
- ▶ Pre appointment corporate tax compliance is not a responsibility of the IP. However, the submission of pre-appointment returns may be beneficial when required to support tax attributes or support a refund claim.
- ▶ Under the statute of limitations, HMRC has two years to raise an enquiry into a corporation tax computation. However, clearance may be obtained prior to the winding up of a business but this may lead to discussions/reviews by HMRC.
- ▶ Prior to the appointment of any IP, directors should have regard to their legal duties and insolvency law, since the duty to act in the best interests of shareholders is overridden by a duty to act in the interests of the creditors where a company is insolvent or close to insolvency. Legal actions taken prior to the appointment of an IP need to be correctly legally implemented to avoid reversal by an IP (e.g. transactions at an undervalue/preference, or which put assets beyond the reach of creditors, are potentially reversible).

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5c. The impact of insolvency within the group: VAT issues

Key: ■ Next ■ Beyond

The appointment of an IP also has a number of impacts from a VAT perspective, such as impacting the accounting periods for VAT purposes and potentially breaking VAT grouping relationships.

There are a number of areas where considering tax can be beneficial, such as understanding potential disposal structuring options, re-registration, and the treatment of ransom payments.

Impact of insolvency

- ▶ The appointment of an IP can impact a number of aspects from a UK VAT perspective.
- ▶ Where it is envisaged that a business sale will be undertaken, it can be beneficial to consider key tax structuring considerations such as a potential hive down of the desirable business into a Newco and whether the sale of the hived down assets should be subject to VAT or qualifies as a Transfer of a Going Concern (TOGC).
- ▶ The appointment of an administrator causes a VAT accounting period to end. The appointment also has consequences where there is a VAT group and not all of the VAT group members will be subject to the process. Some of these entities may be entitled to re-register for VAT on a legal entity basis or as a new group but this process can be difficult to navigate.
- ▶ Following the appointment of an administrator, the post-appointment VAT returns cannot be submitted electronically and are not subject to Making Tax Digital requirements. Instead, the VAT returns are submitted on paper VAT100 forms.
- ▶ Presently, HMRC should not be offsetting pre appointment VAT debts (payables) with post appointment credits (repayments). Therefore, this issue needs to be actively monitored and managed.
- ▶ Where a company ceases to trade, there are a number of VAT impacts. Amongst others, this includes the ability to re-register, how to deal with VAT on the disposal of any assets, and any partial exemption issues.
- ▶ Key suppliers may need to be retained in cases of trading administrations. Where this is the case, it is critical to be mindful around time of supply (and payments) and the nature of the supplies to ensure optimisation of VAT accounting and recovery.
- ▶ Overseas VAT registrations and dealing with overseas aspects of the business needs to be carefully considered as some overseas tax authorities are more accustomed to dealing with insolvencies than others.

Practicalities

- ▶ Often VAT compliance can be neglected in the period up to a formal appointment resulting in limited tax information available, particularly if key staff are not retained.
- ▶ The pre-appointment VAT compliance is not a responsibility of the IP, however the submission of pre-appointment returns can be beneficial when required to support the VAT attributes available in the business or where a claim can be made resulting in a cash benefit.
- ▶ Priority of creditors is important at the moment with HMRC below creditors secured by floating charges. Consequently, off-setting of pre and post appointment credits and debts is not permissible. However, this may change on 1 December 2020.
- ▶ Cash accounting for VAT purposes is not appropriate in the vast majority of administrations. Therefore, it is important to understand time of supply and therefore recovery.
- ▶ Under the statute of limitations, HMRC has four years to raise an enquiry into a VAT return, however clearance can be obtained prior to de-registration.

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In summary: what comes next and beyond?

The challenges and opportunities we have highlighted in the pages above are necessarily interlinked.

The most effective responses are likely to come from a strategy that draws on all the issues as part of a longer-term plan to not just restart business but to create a business that is well positioned for the 'new' environment that follows on from COVID-19.

We will be sharing our insights on the trends we see evolving on our dedicated [COVID-19 website](#).

Your usual EY contact will also be keeping you up to date with developments and would welcome the chance to discuss your thoughts on the future.

Key questions to consider

COVID-19 affects industry ecosystems and consumer behaviours at many different levels. The size of government interventions around the world and the consequences for the labour markets indicate the scale of its economic impact.

Some of the key questions you may like to consider in preparing for the world beyond COVID-19 include:

- ▶ How will customers react and what will that mean for the business?
- ▶ What changes will be needed to the supply chain – perhaps to sourcing of goods and the attitude to redundancy in the system? What impact will that have for the current operating model?
- ▶ Will there be new ways of working in which people leverage technology in new collaborative ways reducing traditional 'office-based' worktime?
- ▶ What other technological changes are likely to be adopted both at the customer interface and within the business? Will there be additional pressures on greater automation of information flows within the business? Could this allow the Tax department more time to interact with the wider business in responding to opportunities?
- ▶ Will there be increased technological change within tax authorities? Will the post COVID-19 environment lead governments to increase investment in digital monitoring and collection tools?
- ▶ What steps will we see from governments to generate and collect revenue to service the COVID-19 debt that has been taken on? Clearly there will be an aim to increase effective enforcement of taxes but will the focus be at an individual country level or will the post COVID-19 environment facilitate international cooperation on tax?
- ▶ In that regard, the digital services tax may be a guide to the future. Will we see an agreement (at least in principle) this year or will individual countries push ahead with their own versions? Will the EU look to establish its own common position and might we even see new EU taxes separate to the digital services tax, to fund the EU budget? Will the 'new' environment see a more limited approach to free trade? Potential trade barriers were already an issue before COVID-19 and the current crisis may cause further reflections.
- ▶ What about the other issues that were dominating discussion before COVID-19? The UK Government is still saying that there will be no extension of the Brexit transition period beyond December 2020. There will still be the need to address commitments made on tackling climate change. Both these issues could have significant business impacts.

How we can help

The scale and diversity of the challenges mean that future strategy will be dependant on the needs of a particular business. We can work with you to monitor developments and adapt your strategies over time. From a tax perspective this could include considering:

- ▶ The structural tax aspects of new capital arrangements (withholding tax, permanent establishments and use of losses).
- ▶ The transfer pricing and indirect tax costs of changes to group structure and changes to supply chain.
- ▶ The potential for new taxes at various levels – early identification may give the chance to pass on some of these costs.
- ▶ The potential for technology to reshape the finance and tax function.
- ▶ New ways of dealing with tax authorities around the world as they adopt new technologies themselves and increase the sharing of information.
- ▶ Management of stakeholders and the need for a public tax strategy.

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