

# VAT on deal fees

Some simple steps and early planning might save 20%

**Read this before engagement letters are issued to a purchaser on a corporate acquisition.**

## Key points

- VAT on M&A fees can be significant - 20% of legal fees, accountancy fees and some investment banking fees. If the client cannot recover the VAT from HMRC then it will be a real cost of the deal.
- VAT recovery is a particularly tricky issue where a UK newco is set up to act as the purchaser on an M&A deal. The law and practice on this issue are in a state of flux but recent HMRC guidance is that holding companies will need to charge substantial management fees if they want to recover the VAT they incur on M&A fees. Charging higher management fees will have other tax consequences that need to be considered.
- You should start planning for VAT recovery before any engagement letters are issued.
- Not all professional fees are subject to VAT. For example, on a real estate deal the agent's fees may be VAT exempt if the deal is structured as a share or unit sale. And if the purchaser is a non-UK company professional fees on an M&A deal will generally not be subject to UK VAT (although non-UK VAT issues may arise).

## If there is VAT how might the client get it back?

Historically, there have been two options:

1. rely upon Newco (assuming that it has a UK establishment) joining the target's VAT group and delay all invoices for professional fees until after completion; or
2. Newco supplies strategic management services to the target group and charges a fee for these.

In the past, HMRC have accepted either approach. However, we generally recommended option 2 (providing management services), which also had the advantage of working when the target could not join a VAT group (e.g. JPUTs and most non-UK companies).

## What is the current HMRC policy?

Recent HMRC guidance (published 25 September 2014) states that VAT grouping alone (option 1) will not work. It also sets out how HMRC thinks option 2 must be structured. The amount of the fee and the evidence supporting the reality of the services is now critical to the success of the VAT arrangements.

The key point is that the management fee must be high enough for the holding company to recover its costs over a "sensible period" (HMRC suggests 5 to 10 years). HMRC will not allow recovery of VAT on deal fees unless the total management fees are of similar quantum. This will have other tax consequences that need to be considered e.g. the deductibility of the fees and how they are taxed in the holding company.

## What do you need to do?

1. Identify the issue at an early stage.
2. Set up Newco as soon as possible.
3. All professional advisers issue their engagement letters to Newco.
4. Newco holds an early board meeting at which it decides to:
  - be actively involved in the strategic management of the target group and the development of its business after completion; and
  - charge for those management services.
5. On completion put in place a management services agreement. In most cases the management fee should be high enough for the holding company to recover its costs over 5 to 10 years but always get tax advice to make sure this does not cause other tax problems. In some circumstances it may be possible to put the management services agreement in place before completion.
6. In most cases Newco will not join the target's VAT group.

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