TOPICAL ISSUES FOR PE FUND MANAGERS

EVERYTHING BUT THE DEAL

WHAT'S INSIDE?

What's Going On? NSIA Insights

3 Key Steps on Sanctions

Stop, Thief!: Protecting your Business from the Insider Threat

A Stitch in Time Saves Nine

Rebalancing Retail

Sunny Uplands or a Damp Squib?

MORE IMAGINATION MORE IMPACT

After a brief break I'm pleased to introduce another edition of Everything But The Deal...

MIKE HINCHLIFFE
Head of Private Equity
+44 (0)7740 914012
mike.hinchliffe
@addleshawgoddard.com

Its safe to say that a lot has happened since our last edition towards the end of 2021, and that is reflected in the content of this issue. And as is so often the case when law meets PE, a prevailing theme would appear to be legislation not always being well-matched with the complex, heavily structured, cross-border world in which our investor clients operate.

Take the introduction of the UK's National Security and Investment Act. Much has been written by us, and other law firms, already given how long this has been in the hopper, but now we are seeing the process in action there are still plenty of uncertainties (and I say that having seen one "call in" at close quarters myself already). The online application is really only suited to plain vanilla M&A, with less clarity about how a typical GP/LP/"stack" structure will be viewed, meaning applications are often made with an extensive "kitchen sink" approach to ensure full transparency. We have already identified a couple of tripwires in the process for the unwary and, perhaps inevitably, some additional SPA content is emerging as a result.

The unprecedented wave of sanctions in response to Russia's invasion of Ukraine is another case in point. Diligence is needed at Investor, Fund Structure and Portfolio levels, and once again the differing sanction regimes in different jurisdictions can bring huge complexity for even the more straightforward PE funds. Whilst sanction regimes have been broadly similar there are differences, and the "new normal" (that phrase again) of carrying on business with such a state of affairs has brought renewed scrutiny to provisions that have for so long been considered boilerplate (much as COVID-19 made everybody pause and think that perhaps force majeure clauses were always there for a reason after all....). Elsewhere adjustments to accommodate changing trends post-COVID are evident in the consultation on Online Sales Tax, whilst some old favourites like ERS tax issues are always worthy of a refresher - as we continue to see ERS issues day in, day out on transactions.

Finally, with so much PE activity focussed on businesses where value is in the know-how and confidential information – technology, business services, financial services, healthcare – I hope our feature on protecting business information offers some food for thought. Again, confidentiality restrictions and restrictive covenants are often viewed by clients as "boilerplate", and some will question whether these are of any real use either in theory (i.e. is it enforceable?) or in practice (but what can we do?). As our article shows, these protections are often enforceable, and the reality is you can do a lot with them to protect a business (and as a firm we often do!). Whilst some unscrupulous vendors or ex-employees may take a view that they can do what they like because everybody else does in an industry, or because the company will have problems proving it, the reality is that where there has been wrongdoing a quick response can both protect the business and have serious implications for the perpetrator. Our article offers a simple 3 step guide for pre-emptive protection, risk assessment and enforcement – and the good news on the latter seems to be that we are seeing the courts move with the times, and be more willing to step in to protect a business where confidential information underpins meaningful stakeholder value.

Whichever of these areas may be most on point for you, we have as always tried to offer some simple practical guidance to get you started. If we can help with any of the topics raised in more detail, please do get in touch.

CONTENTS

KEY TAKEAWAYS FOR FUND MANAGERS THIS QUARTER

WHAT'S GOING ON? NSIA INSIGHTS
PAGE 4

3 KEY STEPS ON SANCTIONS
PAGE 6

STOP, THIEF!
PAGE 9

A STITCH IN TIME SAVES NINE
PAGE 12

REBALANCING RETAIL
PAGE 15

SUNNY UPLANDS OR A DAMP SQUIB?
PAGE 17

SOME EARLY OBSERVATIONS ON THE NSIA

The UK's National Security and Investment Act (NSIA) has been in force for a couple of months now, quickly becoming part of business-as-usual for UK transactions. The expansive nature of the Act (and its even more expansive accompanying guidance!) has led to a significant number of notifications from our firm alone. We are also aware of deals have already been "called in" by the ISU for its more in-depth process.

First, the positives:

There have been some really positive developments. The Investment Security Unit (ISU) at BEIS appears to be sticking by its commitment to review deals at a relatively early stage in proceedings (in contrast to merger control, where the bar for a "genuine intention to proceed" is quite high). It is also moving quite quickly to accept notifications after submission of the form on the portal (although it took a little longer in January, we are now seeing forms accepted the next day, as long as there is no missing information). Clearances for uncontroversial deals are also coming through as soon as they are available, rather than waiting until the 30 working day deadline.

Still, plenty of uncertainty remains, for example:

- The online portal for notification has been designed for vanilla trade deals. It does not contemplate e.g. a private equity structure involving a General Partner, various Limited Partners and a tax stack. Whilst the ISU has made it clear that it views the "acquirer" as the Bidco, this makes it difficult to make sense of the separate request (para 37, Schedule 1 to the Content of Notices Regulation) for certain information "where the acquirer will be acquiring indirect control over the qualifying entity". In reality, at this point most practitioners simply upload the full transaction structure as a standalone document, to ensure they are fully transparent.
- Acquisitions by entities which are, themselves, owned by the UK government are currently caught by the Act. As a matter of principle, it's hard to see how such transactions can raise issues, even potentially. The Secretary of State does have powers to make exemptions that could address this – but it does not seem to be a priority for now.
- The dynamics of whether or not to file are driven by s.13(1) of the Act: "A notifiable acquisition that is completed without the approval of the Secretary of State is void". That means that, unlike in the UK's voluntary merger control system, the parties' incentives are largely aligned. It's not clear, though, what

this means. Is the whole SPA void or just the clauses effecting the transfer? What of related documents such as lending arrangements? And if the transaction is retrospectively validated under the s.16 process, what is the precise effect of that? One for the courts in due course, we suspect.

Some traps for the unwary:

- The online form asks for details of a contact at the "qualifying entity" (i.e. the target) rather than at the seller. The ISU then adopts the practice of copying the target in on correspondence with the purchaser and its lawyers. Think carefully about who to name on your form!

- According to the published guidance, intra-group reorganisations of a group structure above a "qualifying entity" are caught by the notification requirement, even where the ultimate owner remains the same. If the re-org is in preparation for a divestment, it's likely the ISU will require two separate notifications, meaning the clearances may arrive at different times – so make sure your condition precedent is drafted with this in mind.

- If there is a genuinely sensitive agreement, it is likely that the purchaser will not have received it as part of due diligence – so it will not be able to supply the document as part of the notification. So, when drafting the SPA, think about how you oblige the target to provide such documents directly to ISU (or use best endeavours to persuade the counterparty to release them).

As a result of all of that we are starting to see a few themes emerge, as parties seek to cover off their NSIA risk:

- Lenders are starting to think about how they address the requirements in their documents. Borrowers or sponsors are being asked for representations on their NSIA analysis. In some cases, lenders are mandating that non-mandatory transactions be brought to the attention of the ISU, in order to ensure the five-year period (within which the ISU may call-in the transaction) is reduced to six months (by s.2(2)(a) of the Act).

- Buyer, seller, target and their advisers are performing a familiar dance on each new deal, to determine whether the target has activities in a mandatory sector and who should be responsible for certifying that. Ultimately there may be little difference between due diligence questions and warranties, given the risks of voidness and criminal sanctions. In practice, the best results tend to come from pragmatic discussions between both sides, recognising it's in both parties' interests to find the right answer.

BRUCE KILPATRICK
Partner,
Head of Competition
+44 (0)20 7544 5214
bruce.kilpatrick
@addleshawgoddard.com

AL MANGAN
Partner,
Competition & Regulation
+44 (0)20 7544 5352
al.mangan
@addleshawgoddard.com

3 KEY STEPS ON SANCTIONS

Russia's invasion of Ukraine in February 2022 has sparked an unprecedented wave of international sanctions on President Putin and his allies. Private Equity funds may be exposed to upstream risk if their Limited Partners are added to sanctions lists and to downstream risks as aggregation rules may mean that holding a portfolio company within a particular jurisdiction, (e.g. the EU) brings the Fund as a whole within the scope of EU sanctions. Here are 3 broad, practical steps that investors can quickly take to minimise the sanctions risk to their businesses.

INVESTOR DUE DILIGENCE

Funds will want to review existing investor due diligence processes to identify risk. A significant number of wealthy Russians outside of Russia have been added to US, EU and UK sanctions lists in the past month, and the list continues to grow. It is imperative to identify if LPs, or their ultimate beneficial owners, have been designated under applicable sanctions regimes. If this is the case, managers will need to ensure that no payments or distributions are made to the designated person. Steps will need to be taken to assess the risk to the Fund as a whole and in particular to the business operations of portfolio companies.

In addition, any review should identify whether there are any investors who are at risk of being designated. This is because steps can be taken prior to a designation which may be unavailable once the investor has been designated as they will run the risk of falling foul of anti-circumvention laws.

Lastly, funds should also ensure that any due diligence of potential investors is appropriately calibrated and includes an up-to-date sanctions screening process.

REVIEW THE FUND STRUCTURE

This will assist in identifying the applicable sanctions regimes. Funds operating through a multi-jurisdictional fund structure and holding operating companies in multiple jurisdictions will need to carry out an assessment to identify the sanctions regimes which may apply to the group. While sanctions regimes are broadly similar there are important differences. Firms will want to ensure that these deltas do not cause inadvertent breaches. This will also be an important part of managing any investor risk.

A review of fund structure will identify any portfolio companies operating in high risk jurisdictions. This will assist in managing these exposures but also in identifying other areas of risk, for example access to foreign currency. In addition, where there is a risk of future sanctions affecting part of a business, steps can be taken in advance of sanctions being imposed to enable the business to continue in a ring-fenced manner. However, care must be taken as this type of restructuring runs the risk of falling foul of anti-circumvention measures if it is implemented once sanctions are in place.

CONTRACTUAL ARRANGEMENTS REVIEW

If there is a risk of investors being designated, managers will want to review finance documents to identify whether there is any risk of breach of the representations and warranties. Early identification of these risks will enable prompt engagement with lenders.

Managers should review any other contractual arrangements with Russian or Belarusian counterparties both at manager level and across portfolio companies. This review should identify the termination rights, choice of law and jurisdiction clauses in existing contracts. This will enable the business to prepare for any direct impact of sanctions on its contractual counterparties.

If there is a business need to enter into new contracts with Russian or Belarusian counterparties these should contain an up to date sanctions clause which will enable suspension of the contract if sanctions are imposed on the contractual counterparty or in a way which would impact the contractual relationship. Choice of law and jurisdiction clauses should not designate Russian law or the Russian courts.

We have been working extensively with clients to support their responses to sanctions across numerous sectors and jurisdictions. If you need any specific help or guidance please get in touch.

MICHELLE DE KLUYVER
Partner,
Global Investigations
+44 (0)20 7788 5101
Michelle.deKluyver
@addleshawgoddard.com

MATT BUTTER
Managing Associate,
Corporate Crime and
International Trade
+44 (0)131 222 9530
matt.butter
@addleshawgoddard.com

ADDLESHAW GODDARD NOW OPEN FOR BUSINESS IN LUXEMBOURG AND IRELAND

AG continues to invest across Europe with the opening of its first office in **Luxembourg** and the merger with **Dublin-based Eugene F Collins**, two of the leading **funds domiciles** in Europe, and bringing our total number of global offices up to **17**.

Together we'll continue to find the **smartest ways** of delivering the **biggest impact** for clients.

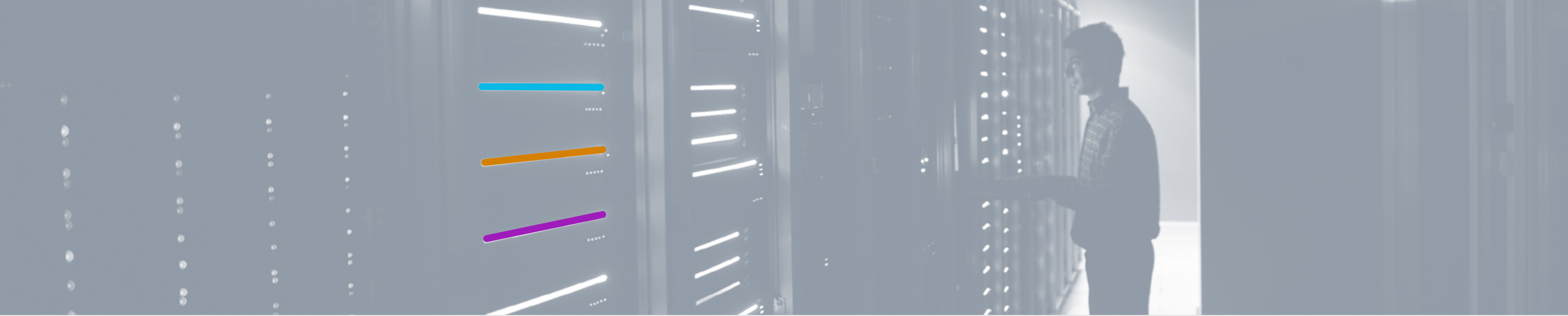
MORE IMAGINATION MORE IMPACT

STOP, THIEF!: PROTECTING YOUR BUSINESS FROM THE INSIDER THREAT

Two of the most valuable assets for a business are often its people and its confidential information. Private equity backed businesses can be particularly vulnerable to senior employees leaving and then setting up in competition.

The double whammy is that when an individual leaves a business there can be a temptation for them to also take confidential information (client lists, product pipelines, pricing information, business plans, and know-how being the typical hit list) and/or ignore restrictive covenants.

This poses a significant threat to any businesses. And it's unlawful. In the dawn of a new era of hybrid working post Covid-19, we are seeing an increase in instructions arising from this insider threat. Working remotely can lead employees to feel more disconnected from their employers and loyalty can diminish, especially if there is a risk of business instability or redundancies combined with a "hot" employment market. There may even be a misconception that they can "get away" with stealing the confidential information purely on the basis of them working from home and having the misplaced notion that their actions either won't be noticed or cannot be traced. In some instances, starting up a new competitor business is easier in a virtual environment and can be done in an employer's time due to the lack of physical oversight. Individuals working from home can be printing, using and/or taking copies of confidential information easily with a view to setting up in competition unless the right controls are in place.



THREE STEPS TO PROTECT YOUR BUSINESS FROM AN INSIDER THREAT

1 PROACTIVELY PROTECT

- Ensure your employment / service contracts contain **express confidentiality obligations that survive termination and adequate and enforceable restrictive covenants.** To be enforceable, a restrictive covenant must be no wider than necessary to achieve a legitimate objective.
- Have **consistent and supportive policies and procedures in place** such as: IT policies, social media policies, acceptable IT use, and BYOD policies. For example:
  - Do your systems allow individuals to access Hotmail/Gmail? Can individuals use USB sticks? These are often the easiest ways for individuals to take confidential information.
  - Can individuals BYOD? If so, do you have a right to inspect those devices?
  - Do you have the right to access and monitor employee accounts without notice?
  - Do you have sufficient training in place so that employees know of the policies applicable to them?
  - Do you have an IT back up system in place for emails/documents?
- Have **well-designed bonus and incentive schemes** to tie individuals into a business and encourage them to stay.
- Consider **appropriate insurance** including: business interruption insurance, director's and officer's liability insurance and any other bespoke insurance applicable to your business.

2 IDENTIFY RISKS EARLY

- Do you have **IT systems** in place which can detect unusual activity? For example:
  - Is an individual regularly accessing confidential information which they don't typically require day to day?
  - Is there a spike in USB stick usage or printing?
  - Is the individual sending emails from their work account to a Gmail or Hotmail email account?
- Ensure appropriate **people management**. Have your ears to the ground. If you hear that somebody is considering moving elsewhere:
  - Speak with them, can they be persuaded to stay?
  - Keep a closer check on IT usage and consider disability access to the most sensitive documents.
  - Can you investigate their recent IT usage to see if there is anything suspicious?
  - Can you use the usual HR process to find out where the employee is going next?
- **Exit procedure:** if a resignation is received or there is a threat of resignation, consider the use of **garden leave** and consider **de-activing IT access asap**. Ensure that all **company devices and documents are returned** as soon as possible.

3 ENFORCEMENT

If you suspect there has been wrongdoing then **act quickly**.

There is a general misconception that if an employee unlawfully takes confidential information or breaches restrictive covenants then there is nothing that can be done about it. That is not correct. There are many options available and the Courts are increasingly willing to step in to protect a business from unlawful conduct. Options include:

- **Delivery Up Order:** an order for an individual to return a company's confidential information or documents within a specified period.
- **Search & Seizure Order:** permission to enter premises to search for and remove confidential materials. This is often granted without notice.
- **Springboard Injunction:** an order intended to prevent an unlawful head start by preventing contact / dealings with certain clients for a period of time.
- **Prohibitory Injunction:** enforcing restrictive covenants from an employment contract such as non-compete, non-poach and / or non-solicitation.
- **Preservation Order:** an order to preserve and not destroy confidential information in the possession of an individual. This is usually combined with a delivery up order or prohibitory/springboard injunction.
- **Damages Claim:** monetary compensation to put the employer into the position it would have been but for the employee's breach.

We do not always have to go to Court to obtain the relief required. Sometimes sending a strong letter before action requesting undertakings can achieve a good outcome.

In the event that an injunction is obtained it is often supported by a penal notice. This means that in the event of a breach an individual would be in contempt of court. This can work as a deterrent as it carries the potential for fines and imprisonment.

For further information, or advice on how to protect your confidential information, please contact us.

NICK ASHCROFT
Partner,
Dispute Resolution
+44 (0)161 934 6278
nick.ashcroft
@addleshawgoddard.com

MICHAEL LEFTLEY
Partner,
Head of Employment &
Immigration Group
+44 (0)20 7788 5079
michael.leftley
@addleshawgoddard.com

WHAT CAN YOU DO?

Here are some practical examples of things we have done for clients to protect their confidential information:

1. Acting for the purchaser of a firm of independent financial advisers to secure a springboard injunction against the sellers who had unlawfully set up in competition and breached restrictive covenants by taking key clients with them.
2. We acted for a PE backed healthcare company in a dispute against its former CFO who unlawfully set up a competing business using confidential information. An interim injunction was obtained requiring the former CFO to deliver up the confidential information and a settlement agreement subsequently reached.
3. We acted for a PE backed company in its defence of an application for a springboard injunction which included an order for delivery up of documents and the dismissal of 5 members of its senior management team. We settled the matter allowing all 5 individuals to stay in the business.

A STITCH IN TIME SAVES NINE

"A Stitch in Time Saves Nine" is the saying, and when dealing with ERS tax matters there really is some truth in it. The legislation relating to managers' shares contains traps for the unwary, many of which are exacerbated by the passage of time and increasing share values. There are some practical things PE houses and portfolio companies can do to avoid trouble down the line.

SHARE OPTIONS

In a nutshell, in the case of unapproved share options employees pay employment taxes on exercise of the options, by reference to the difference between the value of the shares at the time of exercise and the strike price (if any). Share option schemes which only allow exercise at, or not long before, exit (when HMRC is unlikely to be persuaded of a value much less than the exit value) are storing up a hefty tax charge. Tax will not, of course, be the only factor to consider, but consider implementing a scheme with an exercise period, or where the Board can approve exercise, well before any marketing activity or auction process begins. This could also be important if the manager may qualify for business asset disposal relief, as the qualifying period only starts at the time of the exercise when the shares are issued.

EMI share schemes don't face this particular problem – employment taxes arise on grant by reference to the market value of the shares at that time. And the option holder's qualifying period for BADR starts with the grant of the options...

ALLOCATE SWEET EQUITY

Sweet equity which isn't allocated at the time that the PE fund invests cannot benefit from the protection of the BVCA Memorandum of Understanding, which means that issuing sweet equity later down the line will result in employment tax charges unless unrestricted market value is paid. Whether a company has made a fair and reasonable assessment of valuation is a classic (and often hotly disputed) tax dd question, especially when the equity has been allocated within striking distance of a sale. So, the simple point here is to allocate sweet equity as early as possible and certainly to avoid leaving it until just before an exit.

There's a more complex point around sweet equity intended for 'new' members of management which hasn't been allocated when an exit is on the cards. In this case, the position will depend on what the Articles say. An allocation *pari passu* to all shareholders will not change the dilution and so shouldn't give rise to a tax charge (but what's the point of it?). As noted above, allocating it to the incumbent key managers in the run up to the sale will cause tax issues – and so it's best not to stipulate in the

Articles that this must happen. The alternative is to allocate the 'value' of unissued sweet equity to the managers through the waterfall, and provided this right attaches to the shares in the Articles from Day 1, this shouldn't give rise to a taxable transfer of value.

PRESS THE BUTTON ON EQUITY AWARDS

This really is the 'rule number 1': if managers or employees are informally offered equity, then follow through and get the shares issued. The value relevant for ERS purposes is the value at the time the individual acquires a beneficial interest in the shares, and this generally doesn't happen until subscription. So if a company only gets round to actually issuing shares when an exit is on the horizon, then HMRC will be first in line for a slice of the proceeds, even if Mrs Gold the CFO or Mr Green the ESG Director was promised the shares years ago when the company was on the ropes.

Once the value is there, management's own efforts have priced them out of the market, and there isn't much that can be done close to an exit to get the rabbit back into the hat. Exit bonuses, synthetic awards, growth shares and the like all have their place but better to get things done when tax-efficiency and commercial drivers are aligned and when you are not stepping on a future buyer's toes.

GET THIRD PARTY VALUATIONS

Share valuation is a lucrative industry in itself. And it's not surprising given the tax traps mentioned above, the risk of HMRC challenge and (possibly more real) the risk of escalation in tax dd.

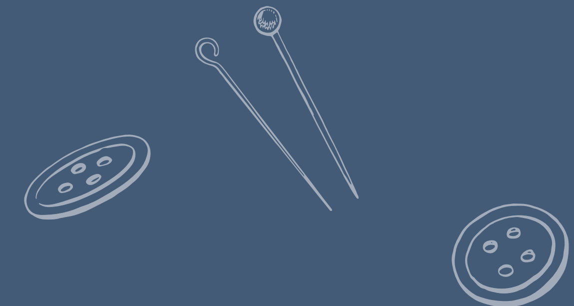
Occasionally, a third party professional valuation is superfluous and feels duplicative (over what the PE house or company can do in-house), but going it alone can be a false economy in the context of potential issues on exit (tax dd again, indemnity request etc) and the risk of hindsight-led arguments from HMRC.

THINK OUTSIDE THE BOX WHEN GETTING TAX INPUT FOR PORTFOLIO COMPANIES

Ask the right questions when seeking tax input. Get, and make sure portfolio businesses get, holistic advice. This doesn't mean writing advisers a blank cheque. It might just be a 'horizon scanner' approach: is there anything else we should be worrying about or aware of going forward? For example, are there issues with the current structure you are buying into? If you're buying from an LLP and your future management team are members of the LLP, are you comfortable none of them hold employment-related securities? Have they thought about this themselves and are you about to compound past errors? Issues that are looked at routinely in one type of structure, may be overlooked in another if the wrong assumptions are made.

All very easy to say, less easy to do in practice, we appreciate. Sacrificing time that could be spent running the business to speak to tax advisers and deal with a bunch of paperwork is never going to feel like the right thing to do. Sometimes, though, pressing the pause button to take stock (no pun intended) really does keep value in the right hands.

JUSTINE DELROY
Partner, Head of
Tax & Structuring
+44 (0)161 934 6770
justine.delroy
@addleshawgoddard.com



OBSTACLES. OPPORTUNITY. DEADLOCK. DEAL. THE DIFFERENCE IS IMAGINATION.

PRIVATE EQUITY WIRE
EUROPEAN AWARDS 2022

Best Law Firm - Fund Structuring

Addleshaw Goddard voted **Best Law Firm – Fund Structuring** at the Private Equity Wire European Awards 2022 and finalists for the **Advisory/Consultancy: Legal, compliance & regulatory, Fund Financing: Advisory Services and Legal: Fund formation** categories at the 2022 Drawdown Awards.

You can rely on us to help your fund find the **smartest route** to the **biggest impact**.

MORE IMAGINATION MORE IMPACT

REBALANCING RETAIL – CAN AN ONLINE SALES TAX HELP REBALANCE THE RETAIL SECTOR?

CHANGING RETAIL LANDSCAPE

More than almost any other sector, the retail sector was affected, for better and worse, by COVID–successive lockdowns resulting in radical changes to our buying behaviours. Retail outlets that rely on footfall and 'try before you buy' were hit hard; by contrast, the online retail sector benefited from a customer base confined to their homes with money to spend and (in some cases) little else to do. The proportion of online retail sales was 37.8% of all sales in January 2021 (rising from only 19.3% in January 2019). So it's no surprise that online retail businesses and the businesses which support the infrastructure of online sales (software, logistics, e-payment technology etc.) are viewed as ripe for investment.

WHY THE CONSULTATION?

The Online Sales Tax (OST) currently under consultation has been presented as a solution to the unfair tax burden, in light of the pandemic and the shifting retail landscape, which falls on retailers with a physical presence who are subject to business rates.

The review of the business rates system in 2021 concluded (to much dismay!) that the system should be retained. Business rates raise over £25 billion a year in England and the Government concluded that no other system could generate similar amounts for the Revenue. The OST would theoretically be used to reduce the level of business rates in England (and to fund the block grants of the devolved administrations). That said, current estimates suggest that an OST would only raise £1 billion per annum.

WHAT'S IN SCOPE?

The consultation unhelpfully doesn't set out exactly how an OST would operate in practice but recognises the challenges. For example, would an OST apply to transactions conducted over the internet in any form such as in-store purchases made via an app? It's accepted that orders over the telephone would not fall in scope but it's noted that sales made via an automated phone line share many characteristics with online sales.

One area that proponents of an OST have suggested should be excluded from its scope are "click and collect" transactions, given that the arguments around the cost of premises for online and in-store retail are not relevant to purchases which are collected in-store. Such purchases rely on access to a conveniently located retail space and may generate footfall in physical shops.

GOODS OR SERVICES... OR BOTH

Advocates of an OST have generally proposed that the tax would apply to online retail sales of tangible goods such as clothes, white goods and food. The rationale is that in-store sales of such products rely on valuable retail premises (often on or near the high street) with commensurately high business rates. Some stakeholders will likely call for exemptions to the OST for certain categories of products such as food or medicine, but does this make sense when such products are subject to business rates when bought in store?

The consultation also makes a case for applying an OST to a broader array of services which operate in competition with providers of in-store services – examples include media, gambling, education and healthcare, and professional services.

B2B INCLUDED?

Given that the rationale for an OST is to lessen the business rates burden for retailers with an in-store presence, the consultation accepts the logic that OST shouldn't apply to business-to-business. Even where the products sold are consumed by the purchasing business, differentiating such cases would be an administrative nightmare. The consultation has already ruled out using a system such as VAT (which avoids creating a mounting tax through business supply chains by allowing VAT registered businesses to reclaim VAT paid to their suppliers).

And what about cross border supplies? Further complications would arise where a purchasing business operates internationally as it may be difficult to identify whether a sale would be treated as made to a UK customer when the purchased item may not be used in the UK.

WHAT IS IT GOING TO COST?

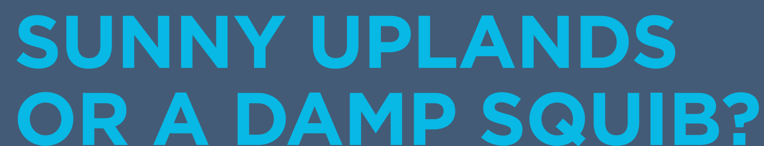
The consultation has not set out the precise mechanism as to how the OST will be calculated. The Government is currently considering a revenue-based approach and a number based on a relevant online sales metric (such as number of online orders or numbers of items sold online). Whilst no rate or flat-rate fee has been proposed, the initial estimates suggest that a revenue-based approach would be adopted and levied at 1% of online sales with a £2 million allowance.

SO, WHAT'S NEXT?

There is currently no plan as to how, in practice, OST revenues could reduce business rates for retailers. There are suggestions, however, that business rates relief could be targeted at lower value properties (noting that this would not reduce business rates for multi-sales channel retailers). Similarly, the consultation recognises that a reduction to retail business rates would likely benefit the landlord and crucially, not the retailer.

So until there is a plan which tackles both sides of the equation, OST won't be the "silver bullet" to address the tax-burden imbalance of in-store versus online retailers. Sadly for your high street bakery, it's a bit half-baked!

CHARLOTTE FALLON
Partner,
Tax & Structuring
+44 (0)20 7544 5352
charlotte.fallon
@addleshawgoddard.com



SUNNY UPLANDS OR A DAMP SQUIB?

HMT recently published its summary of responses to its January 2021 Call for Input (CFI) on a review of the UK funds regime (announced in the 2020 budget), together with an indication of travel in terms of those reforms that HMT will prioritise.

The CFI asked for industry views on potential tax and regulatory reforms and options to improve the UK's position as a funds domicile location and supporting a wider range of more efficient investments better suited to investor needs. Widely seen as an opportunity for the government to truly engage in blue sky thinking post-Brexit, the UK's investment management industry engaged constructively with HMT and its response had been eagerly awaited.

HMT's response identified three areas of priorities cited by respondents to the CFI, alongside a number of further areas that were flagged in the response.

THE LONG TERM ASSET FUND

The introduction of the LTAF as a new authorised fund vehicle to support investor access to longer-term, less liquid assets such as venture capital, private equity, private credit, infrastructure, and real estate has been widely supported. The LTAF was already introduced in November 2021 and is aimed at DC pension schemes, sophisticated investors and some high net worth individuals. Whether it will ultimately succeed in channelling more investments into long term strategies well suited to the PE sector remains to be seen. The LTAF for now remains restricted to a smaller sub-set of retail investors and the DC charge cap remains an obstacle in channelling DC pension scheme monies into PE structures. The industry will be pleased by HMT's commitment to work with the industry in exploring whether further changes are needed to support the LTAF and by the FCA's commitment to consult further on expanding the range of investors that the LTAF can be promoted to.

VAT

HMT's response to the CFI acknowledges stakeholders' desire to ensure that the VAT treatment of fund management and specifically the treatment of fund management fees is competitive, uncertainties or complexities are removed and that the case for zero rating is considered. HMT has committed to a further consultation and review.

Whilst it is encouraging that HMT is alive to the need for a competitive VAT regime to make the UK an attractive option to domicile funds and is committing to a consultation, the response also indicates that zero rating will not be an option. It therefore seems that UK PE fund managers will continue to be incentivised to domicile funds outside the UK to avoid VAT being charged on the supply of fund management services to the fund.

A NEW TYPE OF ONSHORE FUND STRUCTURE FOR PROFESSIONAL INVESTORS

HMT notes stakeholders' desire for addressing gaps in the UK's current offering of fund structures for professional investors. HMT will take forward work on creating a new unauthorised type of fund structure aimed at professional investors. However, HMT is not convinced by the merits of creating a lighter touch authorisation regime for such a structure and rejects a fast track authorisation process. It therefore remains to be seen how attractive this type of fund will be, especially when compared to professional investor fund structures in Luxembourg and Ireland that benefit from simplified authorisation regimes.

A MISSED OPPORTUNITY FOR LIMITED PARTNERSHIP REFORM

The PE community also lobbied for improvements to be made to the limited partnership regime.

UK limited partnerships – both English and Scottish – have formed the backbone of PE funds for many years but their use has generally been in decline both for tax and non-tax issues. For example, these issues include the lack of separate legal personalities for English limited partnerships, continued uncertainty around the application of the Partnerships (Accounts) Regulations 2008 and the inability to set up limited partnerships as umbrella funds as well as the requirements for partners to obtain UTRs and the potential application of stamp duty and SDLT to rebalancing of LP's interests in funds on the admission of new investors as well as transfers of LP's interests.

The government in its response indicates that it is keen to support the limited partnership but substantive reforms seem to have been kicked into the long grass. The government states that non-tax proposals on improving the limited partnership regime are not a priority for now. On the tax side it considers the tax treatment of UK limited partnerships as robust and is consistent with the tax treatment of UK partnerships and merely commits to keep "under review" the potential tax barriers that have been identified. Many in the PE industry will have hoped for more given the international recognition of the UK limited partnership regime.

The response is worth a read in full and the above is only a snapshot of the issues considered. HMT had already excluded from the scope of CFI a more wide-ranging consideration of the future of the now on-shored AIFMD. It remains to be seen whether some of the more recent mood music from the government around the review of retained EU law will translate into tangible action, let alone a cutting of perceived "red-tape".

For now, the jury remains out on whether future government action taken on the back of the funds review will ultimately guide the UK fund management sector to sunnier uplands or turn out to be somewhat underwhelming.

JAN GRUTER
Partner,
Investment Management
+44 (0)141 574 2327
jan.gruter
@addleshawgoddard.com

PROBLEMS. POSSIBILITIES.
COMPLEXITY. CLARITY.
OBSTACLES. OPPORTUNITIES.
THE DIFFERENCE IS IMAGINATION.

AUTHORS

NICK ASHCROFT
Partner,
Dispute Resolution
+44 (0)161 934 6278
nick.ashcroft
@addleshawgoddard.com

MATT BUTTER
Managing Associate,
Corporate Crime and
International Trade
+44 (0)131 222 9530
matt.butter
@addleshawgoddard.com

MICHELLE DE KLUYVER
Partner,
Global Investigations
+44 (0)20 7788 5101
Michelle.deKluyver
@addleshawgoddard.com

JUSTINE DELROY
Partner,
Head of Tax Structuring
+44 (0)7921 406771
justine.delroy
@addleshawgoddard.com

CHARLOTTE FALLON
Partner,
Tax & Structuring
+44 (0)7720 810542
charlotte.fallon
@addleshawgoddard.com

JAN GRUTER
Partner,
Investment Management
+44 (0)7784 298011
jan.gruter
@addleshawgoddard.com

MIKE HINCHLIFFE
Head of Private Equity
+44 (0)7740 914012
mike.hinchliffe
@addleshawgoddard.com

BRUCE KILPATRICK
Partner,
Head of Competition
+44 (0)20 7544 5214
bruce.kilpatrick
@addleshawgoddard.com

MICHAEL LEFTLEY
Partner,
Head of Employment &
Immigration Group
+44 (0)20 7788 5079
michael.leftley
@addleshawgoddard.com

AL MANGAN
Partner,
Competition & Regulation
+44 (0)20 7544 5352
al.mangan
@addleshawgoddard.com

MORE IMAGINATION MORE IMPACT

addleshawgoddard.com

© Addleshaw Goddard LLP. This document is for general information only and is correct as at the publication date. It is not legal advice, and Addleshaw Goddard assumes no duty of care or liability to any party in respect of its content. Addleshaw Goddard is an international legal practice carried on by Addleshaw Goddard LLP and its affiliated undertakings – please refer to the Legal Notices section of our website for country-specific regulatory information.

For further information, including about how we process your personal data, please consult our website www.addleshawgoddard.com or www.aglaw.com.