Chapter 1

Deal Structures—Shares or Assets?

There are two basic structures for buying and selling a business: a sale and purchase of some or all of the assets (subject to some or all of the liabilities) of that business or, if the business is being carried on by a company, a sale and purchase of the shares in that company.

On a sale of the assets of a business, the seller will sell and the buyer will buy all of the assets (or, possibly, certain agreed assets) of the business and the ownership of each of those assets will be transferred from the seller to the buyer. On the sale and purchase of the shares in a company, on the other hand, the assets and liabilities of the business will continue to belong to the company and its existing contractual relationships will be unaffected—the only change of ownership will be in respect of the shares in that company.

For example, Buyer PLC (Buyer) may wish to acquire the business which is being carried on by Target Limited (Target), a subsidiary of Seller Limited (Seller): on a sale and purchase of assets, Target will sell to Buyer the undertaking and assets of its business and each of those assets will be transferred from Target to Buyer while, on a sale and purchase of shares, Seller will sell the shares in Target to Buyer but the undertaking and assets of the business will continue to be owned by Target.

Whether or not a particular transaction proceeds as a sale and purchase of the assets of the business or of the shares of the company which carries on the business will be a matter for discussion and negotiation and it is quite likely that one party (more often than not, the buyer) will prefer the transaction to proceed as a sale and purchase of assets while the other (more often than not, the seller) will prefer a sale and purchase of shares. In particular, there may be tax considerations which make a sale of shares more attractive for a seller, while there may be commercial considerations which make a purchase of assets more attractive to a buyer.

1.1 Tax considerations for the seller

Tax issues are discussed in more detail in Chs 13 and 14 but, in summary, individual sellers are likely to want to structure the transaction as a sale and purchase of shares as the sale proceeds will then be received by them personally and will normally be subject to more attractive capital gains tax rates. A sale of assets may well give rise to a "double charge" to tax as the selling company is likely to pay tax on the sale of its assets and, if the intention is to distribute the net sale proceeds to the shareholders of the selling company, a further tax charge is likely to arise. Similarly, a corporate seller who is entitled

to the Substantial Shareholdings Exemption, which is discussed in Ch.14, is likely to want to make sure that the transaction is structured as a sale and purchase of shares.

These issues are discussed in detail in 13.1 and 14.1, below.

1.2 Tax considerations for the buyer

Although tax considerations are likely to make a purchase of assets more attractive for a buyer, a purchase of shares may also offer some advantages.

1.2.1 On a purchase of assets, the buyer may be able to obtain a deduction as a trading expense for corporation tax purposes of the cost of any trading stock which forms part of the assets acquired and is likely therefore to wish to argue for a relatively high apportionment of the purchase price to trading stock, rather than to assets (such as goodwill) which do not qualify for deduction as a trading expense.

1.2.2 The cost of acquiring industrial buildings, plant and machinery and some intellectual property rights will attract capital allowances and will therefore qualify for a deduction against income for tax purposes, which will effectively reduce the purchase price. For the seller, on the other hand, there is the risk of balancing charges if the assets in question are sold for more than their written-down value.

In recent years, increases in the rate of stamp duty and, subsequently, the introduction of stamp duty land tax have made acquisitions of assets less attractive to a buyer than was previously the case—currently, on a purchase of shares, stamp duty will be payable at 0.5 per cent of the consideration while, on a purchase of assets which include interests in freehold or leasehold property, stamp duty land tax may be payable at up to 4 per cent of the purchase price payable for those interests.

One result of this has been that a prospective buyer of a property which is owned by a company may well be prepared to consider acquiring the shares in the company rather than acquiring the property directly, in order to pay the reduced rate of stamp duty.

Inevitably, of course, this will be subject to other considerations which are discussed below and, in particular, the buyer will wish to be certain that the company they are acquiring is "clean" or that appropriate warranties and indemnities are in place in respect of any unexpected or contingent liabilities.

Stamp duty issues are discussed in more detail in Ch.15.

1.3 Other considerations

In addition to tax issues, there are likely to be other reasons which may make a sale and purchase of shares more or less attractive to one or both parties than a sale of assets:

1.3.1 The principal advantage to a seller of selling shares is likely to be the fact that the seller will, on completion, be able to walk away from the business, save to the extent of any warranties or indemnities which they may have to give to the buyer.

On a sale of assets, by contrast, the rules regarding privity of contract will mean that, as between the seller and the third parties concerned, the seller will remain liable for all creditors and other liabilities incurred by them and for all goods sold by them before the sale, despite the fact that, as between the seller and the buyer, the buyer may agree to assume those liabilities. If the buyer fails to do so, it is very likely that the third parties concerned will pursue the seller, who will have to rely on their ability to enforce any relevant covenants or indemnities given to them by the buyer, which may be of no value if the buyer is in financial difficulties.

If, therefore, Seller Limited sells the entire issued share capital of Target Limited to Buyer PLC, Buyer will acquire Target "warts and all", with all of its assets and liabilities. If, however, the transaction proceeds as a sale and purchase of assets, then all liabilities of the business will, as between Target and the third parties concerned, remain with Target: if Buyer fails to satisfy them, the only remedy of Seller/Target will be to pursue Buyer under any covenants or indemnities which they may have given in the sale and purchase agreement.

This can be a particular concern if it is proposed that Target should sell its undertaking and assets to Buyer and should then be put into members' voluntary liquidation, with the intention of returning the sales proceeds and any other assets it may have to its shareholders, i.e. to Seller. It may be difficult for the directors of Target to make the necessary declaration of solvency if Target has residual liabilities to third parties in the event of Buyer failing to discharge the obligations that it has agreed to assume or has liabilities (for example) in respect of goods or services supplied by Target before completion. Even if the directors are able to make their declaration, the insolvency practitioner who is appointed as liquidator will be reluctant to make a distribution of Target's assets until enough time has elapsed for them to feel confident that no unexpected claims will be brought against Target. In practice, if Seller is a substantial company, the insolvency practitioner may be prepared to make a distribution on the basis of an indemnity.

1.3.2 A sale and purchase of assets involves the need to identify every single asset and liability of the business and to determine whether that asset or liability is to transfer to the buyer or is to remain with the seller. It will therefore be absolutely essential to ensure that the sale and purchase agreement identifies—by lists or by generic descriptions—exactly which assets and which liabilities are to transfer to the buyer and which are to remain with the seller.

1.3.3 It will also be necessary to comply with all necessary formalities for the transfer of title to each and every asset which is included in an assets sale and purchase: for example, moveable plant and equipment will normally be

transferred by delivery, while it will be necessary to have formal transfers or assignments of certain other assets, such as contracts, debtors and land.

On a sale and purchase of shares, however, all that is needed is a formal transfer of the shares in the company in question and all underlying assets and liabilities of the company will then pass to the buyer along with the shares. To be more precise, there will be no change in their ownership at all, simply a change in the ownership of the company which owns them.

This obviously has the advantage of simplicity and (generally) speed.

1.3.4 One of the consequences of the need to transfer each and every asset from the seller to the buyer on a sale and purchase of assets is that it may well be necessary to obtain the consent of third parties to the transfer and this would not be an issue in the same way on a sale and purchase of shares.

For example, on a sale and purchase of assets, it will be necessary to have a formal assignment of any property leases and the consent of the landlord is likely to be required.

Similarly, there may well be contracts with key customers or suppliers which may contain terms which prohibit their being transferred or assigned without the consent of the other party. Even if that is not the case, the law of privity of contract is likely to make it desirable (at the very least) to approach the other parties to key contracts in order to ensure that they will continue to deal with the business once its ownership has transferred to the buyer.

The buyer will want to do so, if at all, before entering into a legally binding obligation to make the acquisition, while the seller is likely to be concerned about the potential damage to the business if approaches are made to third parties before there is a legally binding commitment from the buyer.

This issue is discussed in more detail in Ch.4.

1.3.5 Apart perhaps from tax considerations, the principal attraction for a buyer of buying assets rather than shares is that, on an acquisition of shares, the buyer acquires the company with all of its historic, current, prospective and contingent liabilities, whether the buyer is aware of them or not.

The buyer will seek protection against such matters by appropriate warranties and/or indemnities in the sale and purchase agreement but such contractual protections may be of limited value: they will inevitably be subject to limitations, there may be issues over quantification of the buyer's loss (particularly in the context of warranty claims), litigation is inevitably time-consuming and expensive and, ultimately, the best drafted warranty or indemnity will be of no value whatsoever if, when the buyer seeks to enforce it, the seller does not have the financial means to satisfy the claim.

On a sale and purchase of assets, by contrast, the buyer will have the opportunity of agreeing specifically which assets and liabilities are to be included in the sale and which are to be excluded. For example, the buyer may (subject to negotiation) be able to take over the burden only of those contracts of the business which they wish to take over and may therefore (again, subject to negotiation) be able to exclude unknown or loss-making contracts.

A purchase of assets is therefore particularly attractive where the selling company is subject to a major claim in litigation or some other contingent liability or where the business being acquired is one which is likely to attract significant product liability or employers' liability claims which the buyer would not want to assume. However, even on a purchase of assets, some employers' liability claims may pass to the buyer by virtue of the operation of the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("TUPE"), which are discussed in more detail in Ch.21. Indeed, the provisions of TUPE regarding consultation, changing terms of employment and protection against dismissal, which are also discussed in more detail in Ch.21, may of themselves make a sale and purchase of shares more attractive than a sale and purchase of assets.

The perceived ability to leave behind all contractual liabilities may, however, be illusory—if there are product warranty or similar claims from customers arising from the seller's ownership of the business, the buyer may well have to accept that they will have to deal with these problems if they wish to retain the customers and, in these circumstances, the buyer should seek to agree with the seller a basis on which the buyer will deal with such claims but at the cost of the seller.

1.3.6 The ability to exclude unwanted or unknown liabilities will generally mean that, when buying assets, the buyer's due diligence process can be more limited, in that it need not cover matters which are to be excluded from the sale. One attraction for a seller of selling assets may therefore be that the warranties and indemnities to be given on a sale of assets are likely to be less than on a sale of shares. The downside of that, however, for the seller is that such liabilities will not be the subject of warranties and indemnities but will instead remain the direct responsibility of the seller.

1.4 Situations where circumstances dictate a sale and purchase of assets

There are some circumstances where the only realistic choice is a sale and purchase of assets rather than a sale and purchase of shares, and these include:

1.4.1 Where the business being acquired is a division of the selling company rather than a separate subsidiary, there may be no real alternative to a sale and purchase of the assets of that division.

1.4.2 In years gone by, where there were potentially valuable tax losses in the business, it was common for the assets to be hived down into a new subsidiary

In circumstances where completion cannot take place without seeking consent from the NCA, particularly if the timetable is tight, the solicitor may come under considerable pressure from the seller and their solicitors to proceed more rapidly. In practice, it is normally possible to obtain a rapid clearance from the NCA but, if the matter in question comes to their attention as a result (for example) of a last-minute disclosure, they will find themselves in an extremely difficult position.

This does not purport to be anything approaching an exhaustive summary of the money laundering rules and the way in which they impact on transactional work but is simply intended to remind professional advisers of the need always to be mindful of those rules when engaged on a corporate transaction. Professional advisers who have particular concerns are strongly recommended to refer to the guidance issued by their own professional body.

Chapter 6

Due Diligence—Financial

6.1 The purpose of financial due diligence

Financial due diligence investigations typically provide an appraisal of financial matters (such as accounting policies and methodologies, trading results, assets and liabilities), as well as the provision of information on other areas, such as employees, management organisation, and financial systems. The main purposes of financial due diligence investigations can include:

6.1.1 to identify any issues or areas of risk of which the buyer and any funders may not already be aware and which may affect the purchase arrangements;

6.1.2 to confirm the reasonableness of the key financial information presented by the seller;

6.1.3 to assist the buyer in determining the purchase consideration;

6.1.4 to identify matters in respect of which the buyer should seek warranties and indemnities from the seller;

6.1.5 to assess the level of ongoing working capital requirements for the target business;

6.1.6 to help the buyer develop plans for the post acquisition management and development of the target business; and

6.1.7 to "test" any synergy benefits assumed by the buyer to arise in respect of the acquisition.

It is important to appreciate that, typically, a financial due diligence investigation does not constitute an audit of the target business, with no detailed "audit" verification work being carried out in accordance with International Standards on Auditing (United Kingdom and Ireland) or any other relevant auditing standards. In many cases, the accountant will accept the explanations and assurances received from the Target's directors, officers and employees. The accountant will normally satisfy themselves that information received is internally consistent.

This chapter considers financial due diligence work in connection with a trade purchase or a management buy-out or buy-in. It is not intended to cover the work of a reporting

accountant on a Stock Exchange transaction, although due diligence procedures form the basis of much of the reporting accountants' work in producing their "long form report" and their "working capital report" on such assignments.

6.2 Contractual terms with accountants

6.2.1 Prior to taking on a due diligence assignment, the accountants must carry out various professional checks to confirm that they can carry out the work, including an assessment of any potential conflicts of interest (if, for example, they as a firm have a relationship with more than one party to the transaction) and of any other ethical reasons why they may not be able to act.

6.2.2 Once these checks are completed, the accountants should provide a formal letter of engagement for their due diligence assignment in advance of commencement of their work. This would normally include the following matters:

6.2.2.1 scope and purpose of the due diligence;

6.2.2.2 limitations in scope, making it clear what areas the accountants will not cover in their review;

6.2.2.3 timetable and reporting requirements;

6.2.2.4 limitation of liability;

6.2.2.5 fee arrangements;

6.2.2.6 communication and complaints procedure; and

6.2.2.7 detailed contractual terms.

Where external funding is a feature of the transaction, the accountants may be engaged to provide a report addressed to both the buyer and the bank, venture capitalist or other third party investor. In such circumstances, the accountant must assess any conflict of interest before accepting the engagement; for example, the accountant could not advise the buyer on bank funding and the terms of any such funding while, at the same time, accepting a duty of care and issuing that same report to the bank.

In the case of a management buy-out or buy-in, a "Newco" is often formed as the vehicle to acquire the target business. The Newco may not be in existence at the time that the accountants are commissioned to undertake the work. In such circumstances, it is usual for the letter of engagement to provide for the Newco to subsequently sign up to the letter and thereby become an addressee of the accountants' report, upon formation of the company.

6.2.3 Accountants will usually seek to limit their financial liability on due diligence assignments against any claim arising out of the engagement. The basis of limitation and the way it is put in place will vary from firm to firm. The financial limit may be expressed by reference to a multiple of the fee or a fixed amount, sometimes set by reference to a scale based on transaction size. What is an appropriate financial limit can vary substantially between transactions.

6.2.4 Some of the larger accountancy firms have reached an agreement with the British Venture Capital Association for limitation of liability where one of their members is involved in a transaction and this has become the general market "norm" for private equity transactions. The agreement may be summarised as follows:

Value of Transaction	Liability cap
Under £10 million	Value of transaction
£10 million to £55 million	£10 million plus one third of the excess of the value of the transaction over £10 million (resulting in a cap which progressively rises to £25 million for a £55 million transaction)
Over £55 million	£25 million, together with proportionality*
* *Proportionality is the apportionment of liability between parties by reference to responsibility or blame for the situation giving rise to a claim. Without proportionality, the liability for all of a loss could fall on the accountants, irrespective of their culpability.*	

6.2.5 Accountants may seek further to reduce their level of liability cap when they are engaged on a "limited scope" piece of work.

6.2.6 Fees for financial due diligence work can be based on stated charge out rates applied to hours worked or, more usually, to a fixed fee for the work specified in the engagement letter (albeit this can be expected to be tied to a number of assumptions, such as the reasonable availability of information within an agreed timetable or the number of revisions of forecasts to be reviewed).

6.2.7 In order to guard against any risk to the accountant's objectivity, the professional standards prohibit fees on due diligence work to be undertaken on a contingent basis (i.e. the total fee being conditional upon the transaction proceeding). It does allow a "differential" fee level, dependent upon whether the transaction is completed, provided that this reflects any additional risk and responsibility to the due diligence provider if the transaction takes place. This allows for separate "fail" and "success" fees to be quoted. While there is no set range for a success or an abort fee, anything outside a range of + or – 30% of

the "base fee" could be regarded as excessive and could leave the accountant open to challenge. This could cause difficulty where the client has limited funds to pay for the due diligence if the transaction fails (as can sometimes be the case, for example, on a management buy-out). It is rare for a bank to underwrite due diligence fees on a transaction, but some venture capital houses may do so.

6.3 Setting the scope of work

6.3.1 Setting the right scope of work is a key area to address early in the process, as financial due diligence can vary widely in scope and content, depending on circumstances. It can cover aspects of the broad range of a target's business or be very focused on a few areas of specific interest to the buyer. This will typically depend on:

6.3.1.1 the existing knowledge of the buyer and/or investor and/or financier;

6.3.1.2 the perceived degree of risk involved;

6.3.1.3 the size and complexity of the target business;

6.3.1.4 whether the transaction is an asset or share purchase;

6.3.1.5 the value of the transaction; and

6.3.1.6 the time available.

6.3.2 In the case of a purchase of assets, due diligence may be focused principally on the categories of assets being acquired and liabilities being assumed. In the case of a share purchase, where the liabilities of the target company are being assumed, a more extensive investigation is typically required. However, even in the case of an assets purchase, an understanding of underlying trading history is generally advisable.

6.3.3 An experienced buyer, buying in a sector in which they already operate, may choose to carry out a large part of the due diligence in-house.

6.3.4 Typically, private equity investors will require more due diligence by professional advisers than a trade buyer. Accountants experienced in due diligence work can make recommendations as to particular areas of focus for their review—for example, identifying likely areas of judgement in the preparation of the accounts.

6.3.5 If a buyer requires external acquisition finance, prospective funders will often require independent due diligence (with a principal focus on forecast performance) to be undertaken on both the target and the enlarged group.

6.3.6 Set out in Appendix 1 as a guide, are certain typical sections and areas of focus that can be covered in a financial due diligence report. It is important to emphasise, however, that the scope of any review should be tailored for each project.

6.3.7 Sometimes the buyer's solicitors may not be fully aware of the scope given to the accountants who are carrying out the financial due diligence and vice versa. There can, therefore, be a danger of something "slipping through the net"—for example, the accountants may be instructed to report on the tax affairs of the target company on a sale and purchase of shares but it is always possible that their instructions will not extend to advice on the tax structure of the transaction generally. The buyer's solicitors should also, therefore, make sure that the scope of their work is clearly set out and agreed.

6.4 The financial due diligence process

6.4.1 As discussed earlier, accountants are not permitted to work on a "contingent" fee basis, so to appoint a financial due diligence provider represents a cost investment for the buyer. Partly as a consequence of this, financial due diligence is typically commissioned only after Heads of Agreements have been signed (ideally granting the prospective buyer a period of exclusivity on the deal). It is also quite common for the seller to be asked to underwrite at least part of the buyer's due diligence fees in circumstances where the seller unreasonably causes the transaction to be aborted. These issues are discussed in more detail in Ch.3.

6.4.2 To be most effective, the accountants need a full understanding of their client's objectives and strategy for the acquisition and their key commercial drivers. There may be occasions when the specialist nature of the target business requires accountants with specific industry or sector experience to carry out the due diligence.

6.4.3 Once terms of engagement and scope have been agreed, and the initial planning of the work has been completed, the typical steps in undertaking a financial due diligence exercise are as follows:

6.4.3.1 detailed search of public information sources (websites, Companies House, etc.);

6.4.3.2 issue an information request list to the target (many firms have a standard checklist which they can tailor for a specific assignment. It is often most efficient to co-ordinate requests with other due diligence providers). Care is needed not to "over burden" the target management with a list which is not properly tailored to the scope of work and the target's business;

6.4.3.3 initial meeting with management of target;

Jimmy Mack set up the company in June 1965 and has agreed with HMRC—Share Valuation that his 100 per cent shareholding was worth £500,000 in March 1982.

On the basis that Jimmy makes a claim for ER against his "capital distribution" gain, his tax liability would be calculated as follows:

	£
Capital distribution	3,500,000
Less: March 1982 base cost	(500,000)
Capital gain	3,000,000
Less: Annual exemption	(11,000)
Taxable gain	2,989,000
ER CGT @ 10%	298,900

13.8 Seller tax planning—some final thoughts

Carefully structured tax planning is an essential pre-requisite for those wishing to sell their company. Sellers will normally seek to sell their shares (to avoid the additional corporate tax costs that arise on asset sale and to reduce their commercial risk).

For many owner-managed companies, the main focus will now be securing the availability of ER, which will provide an "exit" CGT rate of 10 per cent (up to a maximum lifetime gains limit of £10 million). To the extent that ER is not available, the seller shareholder's CGT rate will be 28 per cent. Some sellers may wish to consider emigration, but this brings its own problems. Whilst this route may be initially appealing, many sellers are "put off" by the inherent restrictions (such as the upheaval of their family and the inability to regularly watch their favourite football team play on Saturday afternoons). All this requires careful consideration and specialist tax advice both in the United Kingdom and the destination country.

Obtaining carefully considered tax planning advice on the sale of an owner-managed company is essential. Such sales often represent a "once in a lifetime" opportunity to realise the benefits of many years hard work. Both the tax and commercial "grooming" must be considered many months in advance—it should not be an "eleventh hour" exercise. And, as with all tax planning exercises, the seller's commercial objectives should take precedence. Nevertheless, it should not be forgotten that a failure to address a key tax issue could often turn a good deal into a bad one.

Chapter 14

Sale by Corporate Sellers—Main Tax Issues

Following the introduction of the Substantial Shareholdings Exemption ("SSE") in April 2002, most companies should be able to sell their shareholdings in a subsidiary company (or perhaps an equity stake in a joint venture company) on a tax-exempt basis.

However, the availability of the SSE cannot be assumed, since a number of detailed conditions have to be satisfied (see 14.2). The tax implications of selling shares in a company (such as a subsidiary company) which does not qualify for the SSE are dealt with at 14.3.

Sales by corporate sellers (which are part of a 75 per cent group) may also give rise to other tax charges, such as degrouping charges under s.179 of the Taxation of Chargeable Gains Act 1992 ("TCGA 1992"), s.780 of the Corporation Taxes Act 2009 ("CTA 2009") or "clawbacks" of stamp duty/stamp duty land tax ("SDLT") as a result of the target company leaving the seller's group (see 14.4).

Following radical changes in the *capital gains* degrouping rules introduced in the FA 2011, where SSE is available on the sale, the exemption will extend to the degrouping charge as well (see 14.4.1). Unfortunately, this treatment does not extend to the intangibles degrouping rules (see 14.4.4).

14.1 Sale of shares v sale of assets

In cases where a corporate seller is entitled to SSE, it will seek to ensure that the transaction is structured as a share sale (as opposed to an assets sale). However, if a corporate seller is under some pressure (e.g. where a subsidiary or group has financial problems), then a shrewd purchaser is likely to insist that they purchase the trade and assets. In such cases, the sale of the assets is likely to trigger various tax liabilities within the subsidiary (see 13.7.3 for detailed tax consequences of a sale of assets).

In cases of a "distressed" sale, the post-tax sale proceeds will often be used to repay intra-group or bank debt. Any amounts available for the group will normally be extracted by way of dividend (tax-free in the recipient company's hands). Thus, a further tax charge will only arise where the individual shareholders of the parent take some or all of the sale proceeds as a dividend (see 13.7.5).

14.2 Share sales—the substantial shareholdings exemption ("SSE")

14.2.1 Key SSE conditions

The SSE provides an extremely valuable tax relief for corporate disposals of subsidiaries and certain other equity investments. Provided that the detailed conditions in Sch.7AC to the TCGA 1992 are satisfied, any capital gain on the sale should be exempt from corporation tax. The SSE exemption is not restricted to eligible shareholdings in UK resident companies—it also applies to exempt gains arising on the sale of non-resident subsidiaries, etc.

On the other hand, if the disposal satisfies all the SSE conditions but produces a capital loss, that loss will not count as an allowable loss for reducing the company's/group's capital gains (s.16(2) of the TCGA 1992).

The key pre-conditions for the main SSE are:

14.2.1.1 The "investing company" (i.e. the seller) must be a sole trading company or a member of a trading group throughout the "qualifying period" which begins at the start of the relevant 12-month "substantial shareholding" period (see below) and ends when the substantial shareholding is sold. It must also be a sole trading company or trading group member immediately after the disposal—(see 14.2.3 and 14.2.4) (see TCGA 1992 Sch.7AC para.18).

14.2.1.2 The relevant shareholding investment must qualify as a "substantial shareholding" held throughout a 12-month period starting not more than two years before the shares are disposed of (see 14.2.7) (see TCGA 1992 Sch.7AC para.7).

14.2.1.3 The company in which the shares are held (i.e. the investee company) must be a qualifying trading company or qualifying holding company of a trading group throughout the "qualifying period" defined in 14.2.1.1, above, and also immediately after the disposal (see 14.2.8) (see TCGA 1992 Sch.7AC para.19).

These key conditions will now be examined in more detail.

14.2.2 Investing company conditions

In the two-year period before the sale of the substantial shareholding, the investing company must have been a "trading company" (see 14.2.3) or trading group member (see 14.2.4) for at least a 12-month period. Furthermore, the investing company must also be a sole trading company or "trading group" member immediately after the sale (see TCGA 1992 Sch.7AC para.18).

The requirement for the investing company to be a trading company or member of a trading group (see 14.2.3.) immediately after the disposal could deny relief where, for example, a holding company sells its only (trading) subsidiary company. In this case, the holding company will normally be left with the sale proceeds and would only satisfy the post-sale "trading requirement" where the seller company planned to acquire another trade or a significant equity interest in a trading company or group within the near future.

Alternatively, in such cases, it should generally be possible to exempt the gain under the so-called "para.3" exemption. This provides a "secondary" SSE where (broadly speaking) the seller company would have qualified for the main SSE on a notional sale in the past two years (the "trading requirements" are deemed to have been satisfied for these purposes). However, SSE relief can only be enjoyed where the seller company is liquidated (as soon as is reasonably practical) with the sale proceeds being distributed to its shareholders (see TCGA 1992 Sch.7AC para.3).

14.2.3 Trading company

The SSE "trading company" and "trading group member" definitions are virtually identical to the ones applying for CGT entrepreneurs' relief (see 13.3.4) Thus, a "trading company" is a company carrying on trading activities that does not to any substantial extent include non-trading activities. In practice, HMRC apply a 20 per cent de minimis limit for "non-trading" activities. Where a company has "non-trading" activities or investments, HMRC may look at a range of possible measures, depending on the facts of the particular case (see 13.3.4).

Activities carried out for the purposes of preparing to trade also count as trading. A very helpful extension to the meaning of "trading activities" embraces activities carried on with a view to:

- acquiring or starting to carry on a trade; or
- purchasing a significant (i.e. 51 per cent or eligible joint venture) shareholding in another trading company or "trading group".

In such cases, the acquisition must be made "as soon as reasonably practicable in the circumstances". This means that a holding company may still qualify for SSE relief if it sells its only trading subsidiary and reinvests the sale proceeds in buying a 51 per cent stake in another trading company (see 14.2.2) (see TCGA 1992 Sch.7AC para.20).

14.2.4 "Trading group" member

A member of a trading group also qualifies and does not therefore have to carry out a trade in its own right. A "trading group" is defined in much the same way as a sole trading company. For these purposes, a group broadly consists of a principal or parent company and its 51 per cent subsidiaries on a "worldwide" basis. A trading group is one where, taking all the activities of the group together, it carries on trading activities, ignoring any non-substantial (i.e. no more than 20 per cent) non-trading activities (see

TCGA 1992 Sch.7AC para.21). The legislative requirement to take all the activities of the group together ensures that any intra-group transactions are effectively ignored—the group's activities are effectively looked at on a "consolidated" basis. Thus, for example, loans made or property leased to another 51 per cent group member is not regarded as an investment/non-trading activity.

Where the net sale proceeds generated from an SSE sale of a subsidiary are paid out to the parent company's shareholders by way of a dividend within a "reasonable" period, such amounts would not be treated as "non-trading" funds. This should usually enable the seller group to satisfy the "trading group" test immediately after the disposal as required by para.18(1)(b) Sch.7AC to the TCGA 1992.

14.2.5 Special "look-through" rule for joint venture holdings

Where the group holds non-controlling equity investments, these would normally fall to be treated as a "non-trading" activity and may therefore potentially prejudice the seller's trading status, subject to the 20 per cent de minimis test for investments, etc. (see 14.2.3 and 14.2.4, above).

However, most types of joint venture investments should benefit from the helpful "transparency" rule in para.23 Sch.7AC to the TCGA 1992. This provides that where the seller company/group holds at least 10 per cent of the (underlying) joint venture company's ("JVC's") ordinary shares, it should generally be possible to treat it as carrying on an appropriate part of the JVC's trade. Consequently, the seller company/group is deemed to carry on the appropriate part of the JVC's trading activities. However, this beneficial treatment only applies where five or fewer individual or corporate shareholders hold 75 per cent or more of the JVC's ordinary shares.

14.2.6 Risk issues and HMRC's advance "non-statutory" clearance procedure

In many cases, it will be clear as to whether the seller group and target company meet the appropriate "trading" tests for SSE. However, there will often be marginal cases, where the impact of certain "non-trading" activities/assets on the seller's SSE relief is less clear.

HMRC accept that there will be cases of genuine uncertainty in determining whether the relevant requirements are satisfied for the SSE—for example, there may be questions surrounding the group's trading status or the technical application of the legislation to an "unusual" case. In such cases, the seller company can seek advance confirmation from HMRC as to whether SSE will apply under the non-statutory advance clearance procedure. This helpful procedure enables the seller to obtain greater certainty as to whether SSE is available before implementing a sale. HMRC will only deal with applications for advance clearance where it can be demonstrated that the transaction is commercially significant to the business and is genuinely contemplated. The seller must effectively put "all its cards on the table" and highlight the areas of uncertainty and its own tax analysis and conclusions. HMRC aims to respond within 28 days, though complex cases may take longer.

Where the underlying facts clearly show that it would be difficult to sustain a claim for the SSE, alternative tax planning could be considered to mitigate the seller's taxable gain (see 14.3, below).

14.2.7 The "substantial shareholding" requirement

The SSE is also dependent on the investing company having a substantial shareholding in the relevant "investee" company throughout a 12-month period within the two years before the shares are sold (see TCGA 1992 Sch.7AC para.7). It is possible to "look through" any no gain/no loss transfer (such as an intra-group transfer under s.171 of the TCGA 1992) and include the transferor's period of ownership for the purpose of satisfying the above condition.

The investing company satisfies the substantial shareholding requirement provided that it is beneficially entitled to at least 10 per cent of the:

- investee company's ordinary share capital;
- profits available for distribution to the investee company's equity holders (see Chapter 6 of the Corporation Tax Act 2010);
- assets that would be distributed on a winding up of the investee company.

14.2.8 Investee company requirements

The investee company in which the shares are held must be a sole trading company, holding company of a trading group (or trading subgroup) throughout the "qualifying period" which runs from the start of the relevant 12-month "substantial shareholding" period until the disposal date, as well as immediately after the disposal (see TCGA 1992 Sch.7AC para.16).

The investee company's "trading" status ceases to be under the seller's control post-sale and therefore actions taken by the buyer could invalidate the seller's SSE. For example, the buyer may arrange for the investee company's trade to be hived-up. Consequently, the seller should obtain an appropriate warranty from the buyer to the effect that the investee company will continue to satisfy the "trading" requirement for SSE purposes after the sale.

It is clearly important that any "non-trading" activities carried on by the investee company or group fall within the de minimis 20 per cent threshold (see 14.2.3 and 14.2.4) as, otherwise, the disposal would not be protected by the SSE and thus potentially exposed to a tax charge.

The FA 2011 introduced special rules enabling SSE to be claimed on the sale of a "new" subsidiary shortly after assets had been "hived-down" to it by the selling company (see TCGA 1992 Sch.7AC para.15A).

amend the articles in order to introduce such a power and that could be open to challenge.

This will not only be relevant in the case of companies incorporated after October 1, 2009, as there will inevitably be many companies incorporated before that date who decide to adopt new articles which are based on one of the model forms.

Chapter 24

Dealing With a Listed Company

The requirements of the FCA for companies whose shares are traded on the Official List are set out in Chs 10 to 13 of the Listing Rules issued by the FCA under Pt VI of the FSMA ("the Listing Rules").

A company's shares may be subject to a standard listing or a premium listing and this chapter deals with the requirements for companies with a premium listing of equity securities.

The Listing Rules apply to the acquisition or disposal of assets of all kinds but the comments in this chapter are limited to the acquisition and disposal of companies and businesses. It does not attempt to consider in any detail the question of whether a prospectus will be required under the Prospectus Rules. The Listing Rules contain extensive rules regarding the content of circulars issued by listed companies, which are also beyond the scope of this book.

These requirements are generally a matter for the listed company concerned and its advisers but parties who are buying from, or selling to, a listed company will need to be aware of their potential implications on the costs of the transaction and on the timetable to completion.

In particular, where the Listing Rules require prior approval of the shareholders of the company concerned, there will have to be a gap of at least 14 clear days between signing the sale and purchase agreement and completion and there will therefore be issues regarding the conduct of the business between signing the agreement and completion and the date from which the warranties "speak" (as discussed in 10.6).

24.1 Classes of acquisition

Transactions are divided into four classes for the purposes of the Listing Rules: Class 1 Transactions, Class 2 Transactions, and "reverse takeovers" (Listing Rule 10.2.2). In addition, there are particular requirements (set out in Ch.11 of the Listing Rules) for "related party" transactions. Save where the transaction is a related party transaction, every transaction is classified by assessing its size in relation to that of the listed company which is proposing to enter into the transaction and the comparison is made by using the percentage ratios which result from applying the class test calculations which are set out in Annex 1 to Listing Rule 10. The class tests may be varied or modified in the case of certain specialist companies.

At various points in this chapter, the class tests are discussed by reference to the example of the purchase by Buyer PLC (Buyer) of the entire issued share capital of Target Limited (Target) from Adam and Eve (Sellers). Most of the comments will, however, apply equally to a purchase of a business and to sales as well as to purchases.

24.2 The class tests

The class tests are as follows:

24.2.1 *The gross assets test:* the gross assets which are the subject of the transaction divided by the gross capital/assets of the listed company concerned. In the example, therefore, it would be necessary to divide the gross assets of Target by the gross assets of Buyer. For this purpose, the gross assets of Buyer or (as the case may be) of Target are its total non-current assets, plus its total current assets. Where the transaction involves the acquisition of an interest in an undertaking (as defined in s.1161(1) of the Companies Act 2006) which gives rise to consolidation of the target or the disposal of an interest in an undertaking which will result in its assets no longer being consolidated in the accounts of the listed company concerned, the "gross assets the subject of the transaction" means the value of 100 per cent of the target's net assets, even if a lesser interest is acquired or disposed of. If the transaction would not give rise to consolidation or (as the case may be) to assets no longer being consolidated then "gross assets the subject of the transaction" means, in the case of an acquisition, the consideration together with any liabilities assumed or, for a disposal, the assets attributed to the interest in question in the listed company's accounts. In the case of an acquisition of assets, the figure is taken to be equal to the consideration or, if greater, the book value of the assets to be acquired.

If, therefore, Buyer was not acquiring the entire issued share capital of Target but nevertheless was acquiring an interest which required Target to be consolidated in the accounts of Buyer, the "gross assets the subject of the transaction" would nevertheless be the value of 100 per cent of Target's assets. If, however, the interest was not of a size which required Target to be consolidated into the accounts of Buyer, then the relevant figure would be the purchase price, together with any liabilities of Target assumed by Buyer (which, on a sale and purchase of shares, would be most likely to be reflected in the purchase price).

24.2.2 *The profits test:* the profits attributable to the net assets the subject of the transaction divided by the profits of the listed company concerned. In the example, therefore, it would be necessary to divide the profits of Target by the profits of Buyer and, for this purpose, profits are calculated after deducting all charges except taxation. As under the gross assets test, where the target is an undertaking which will be consolidated or will cease to be consolidated, 100 per cent of its profits are included in the calculation, whether or not a lesser interest is to be acquired.

24.2.3 *The consideration test:* the consideration divided by the aggregate market value of all the ordinary shares (excluding treasury shares) of the listed company concerned. In the example, therefore, it would be necessary to divide the consideration payable by Buyer for Target by the aggregate market value of all of Buyer's ordinary shares. If any part of the consideration for the acquisition was to be satisfied by the issue of shares or other securities of Buyer, the value of the consideration would be calculated by reference to their aggregate market value before the announcement. The consideration will generally be the amount to be paid but the FCA may require other amounts to be treated as part of the consideration—for example, if Buyer has agreed to discharge liabilities of Sellers. If part of the consideration is to be deferred (for example as an earn-out), the maximum amount must be used in the calculation and, if there is no maximum, the transaction will normally be treated as Class 1, irrespective of the classification into which it would otherwise fall.

24.2.4 *The gross capital test:* the gross capital of the company or business which is the subject of the transaction divided by the gross capital of the listed company concerned (the test only applying in the case of an acquisition of a company or business). In the example, therefore, it would be necessary to divide the gross capital of Target by the gross capital of Buyer. For this purpose, the "gross capital" of Target is calculated by aggregating:

- the consideration for the acquisition;
- as it is a company which is being acquired, any of its shares or debt securities which are not being acquired;
- all other liabilities (other than current liabilities) of Target, including minority interests and deferred tax;
- any excess of the current liabilities of Target over its current assets.

The gross capital of Buyer will be calculated by aggregating:

- the market value of its shares (excluding treasury shares) and the issue amount of its debt security;
- all other liabilities (other than current liabilities), including minority interests and deferred tax; and
- any excess of its current liabilities over its current assets.

The listed company's advisers will normally, at a fairly early stage in the transaction, submit a formal letter to the FCA setting out the class test calculations and requesting confirmation from the FCA that they are agreed. This must be updated and resubmitted at the date of approval of any circular and the FCA will need to be informed if the percentage ratios change after initial discussions with the FCA and before announcement.

The FCA may require the transaction to be aggregated with other transactions in the previous 12 months, for the purpose of classification. This will usually occur only if it is entered into with the same or a series of connected parties, if it relates to an acquisition of securities in the same target or, together, such transactions lead to the listed company concerned having substantial involvement in a business activity which did not previously form a significant part of its principal activities. In such a case, the latest transaction may be treated as falling with Class 1 even though, alone, it may not do so (Listing Rule 12.2.10).

There are special rules for property companies, mineral companies and scientific research-based companies.

For comparison purposes, assets and profits are generally based on the latest published audited consolidated accounts, or a published preliminary statement of annual results, if the listed company concerned has published such a statement or will have done so by the time that the terms of the transaction are agreed. If, however, a balance sheet has been published in a subsequent interim statement, then gross assets are based on that balance sheet. Figures on which the auditors are unable to report without modification must, however, be disregarded. The figures of the listed company concerned must be adjusted to take account of transactions since the last accounts or half-year results for which information has already been published and the figures of the target company or business must be adjusted to take account of such transactions where the transaction concerned would have been a Class 2 transaction or greater when classified against the target as a whole. Net assets may be adjusted to take account of transactions since the latest accounts or half-year results for which information has already been published.

24.3 Classification of transactions by reference to the class tests

24.3.1 Class 2 transactions

A Class 2 transaction is one where any of the relevant percentage ratios amounts to 5 per cent or more but where none of them exceeds 25 per cent.

The listed company concerned must notify a regulatory information service ("RIS") of the transaction as soon as possible after its terms have been agreed and that announcement must include:

- details of the transaction, including the name of the other party;
- a description of the business in question;
- the consideration and how it is being satisfied (including the terms of any arrangements for deferred consideration);
- the value of the gross assets which are the subject of the transaction;
- the profits attributable to those assets;

- the effect of the transaction on the company concerned, including any benefits which are expected to accrue to it as a result of the transaction;
- details of any service contracts of proposed directors of the company concerned;
- in the case of a disposal, the application of the sale proceeds;
- for a disposal, if shares or other securities are to form part of the consideration received, a statement as to whether they are to be sold or retained;
- details of key individuals important to the business or company which is the subject of the transaction.

The announcement should be made without delay after terms have been agreed and this will usually be when the sale and purchase agreement is signed. The listed company has a general obligation to notify major new developments which are not public knowledge and which may lead to a substantial movement in share price, save for transactions in the course of negotiation where the information is restricted to defined classes of individuals or certain bodies who are made aware of its confidentiality. If there are leaks or there is a possibility of a false market in the company, a warning notification will be appropriate.

24.3.2 Class 1 transactions

A Class 1 transaction is one where any percentage ratio is 25 per cent or more.

In relation to a Class 1 transaction, the listed company concerned must notify a RIS of the transaction as soon as possible after its terms have been agreed and that notification must include the information which would be required if it were a Class 2 transaction. It must also send an explanatory circular to its shareholders and obtain their prior approval (which will be by ordinary resolution) for the transaction in a general meeting. The sale and purchase agreement and any other agreement effecting the transaction must be conditional on that approval being obtained.

It is therefore essential to establish as soon as possible whether a particular transaction will be a Class 1 transaction and to build into the timetable the fact that, once the sale and purchase agreement has been signed, completion cannot take place until shareholders' approval has been obtained, which will involve a notice period of at least 14 clear days.

24.3.3 Reverse takeovers

A reverse takeover will arise where a listed company is acquiring a business, an unlisted company or assets where any of the comparisons give rise to a percentage ratio of 100 per cent or more or would result in a fundamental change in the business of the listed company or a change in board or voting control of the listed company. Where a listed company is proposing to enter into a transaction which amounts to a reverse takeover, it must comply with the Class 1 requirements in respect of that transaction.

The review also identified the need to improve public confidence in this aspect of the insolvency regime and found that, while pre-pack sales are an important means of rescuing struggling businesses, important changes were needed to increase the transparency of such transactions, boost the survival rates of the new business and improve financial terms.

The recommendations of the review include:

- Creating a "pre-pack pool" where details of a proposed sale to a connected party can be shown to an independent person prior to the sale taking place – it was considered that this would increase transparency and give greater confidence to creditors and others that the deal had been subject to independent scrutiny.

- Requesting connected parties to complete a "liability review" for the new company to improve its chances of success.

- Requiring valuations to be carried out by a valuer who holds professional indemnity insurance to increase confidence that the sale is for a fair price.

- Ensuring proper marketing is undertaken in order to maximise sale proceeds.

There appears to have been widespread support for these recommendations from the insolvency professional and other business groups and the Government has indicated that it will introduce legislation in response, as and when parliamentary time allows.

Chapter 27

The CRC Energy Efficiency Scheme

Overview

UK legislation and policy are increasingly setting a trajectory for transition to a low-carbon economy so as to meet international and EU commitments.

In the Climate Change Act 2008, the Government committed to an 80 per cent reduction in greenhouse gas emissions by 2050, with an interim target of 34 per cent by 2020, in each case against a 1990 baseline. On January 22, 2014, the European Commission set out the new climate and energy targets for the EU Member States, which include a target of 40% reduction in greenhouse gas emissions against a 1990 baseline by 2030.

The CRC Energy Efficiency Scheme (the "CRC")

The UK-wide CRC is an integral part of the overall policy and legislative structure which will achieve the United Kingdom's ambitions. The CRC was established under the CRC Energy Efficiency Scheme Order 2010 (as amended)[1] (the "CRC Order").

The CRC came into force on April 1, 2010 and will continue until March 31, 2043. Under the CRC, organisations which are required to participate must submit allowances for each tonne of CO_2 equivalent emitted. It is a cap and trade scheme, meaning that the number of allowances will be limited (except in the early years) but organisations can trade allowances to cover any shortfall or excess. The CRC is administered by the Environment Agency in the UK. Enforcement of the CRC is the responsibility of the Environment Agency in England, the Natural Resources Body in Wales, the Scottish Environment Protection Agency in Scotland and the Chief Inspector of the Department of the Environment in Northern Ireland.

The CRC is divided into seven phases, the first phase being from April 1, 2010 to March 31, 2014. In this first phase of the scheme, the number of allowances was not limited and they were issued at a fixed price of £12 each in 2013/14. From the start of the next phase, the "Initial Phase", on April 1, 2014, the number of allowances will be limited and will be sold in two fixed price sales of allowances for each year. One sale will be based on a cheaper, forecast or forward price and one sale will be a more expensive, retrospective compliance sale. It is expected that, eventually, a secondary market in CRC allowances will emerge.

1 SI 2010/768, as amended by the CRC Energy Efficiency Scheme (Amendment) Order 2011 (SI 2011/234) and the CRC Energy Efficiency Scheme Order 2013 (SI 2013/1119)

Allowances are held in an electronic registry managed by the Environment Agency and are surrendered electronically.

As the CRC was originally enacted, the monies raised from the sale of allowances would be recycled (i.e. paid back) to participants depending on how well they performed in terms of reducing emissions. However, this recycling has now been removed meaning that the CRC is effectively an additional cost of doing business in the United Kingdom.

The CRC applies to large non-energy intensive users (large energy intensive users being covered by the EU emissions trading scheme or climate change agreements) in the public and private sectors and also to charities. Certain government departments must participate, but otherwise participation is determined by reference to qualification criteria based on the consumption of electricity through half hourly settled meters. Examples of participants include banks, retailers, institutional landlords, data centre owners, private equity funds, large joint ventures, private finance initiatives, public-private partnerships, franchises, government departments and local authorities.

An organisation is required to register as a participant for a phase if it meets the qualification criteria for that phase. The qualification criteria for the initial phase onwards is that the organisation has been supplied with qualifying electricity, for the purposes of business activities, charitable activities or activities undertaken by a public body, measured by a settled half hourly meter during the qualification year for the relevant phase and the organisation has been supplied with over 6,000 MWh of qualifying electricity during that period.

Generally, groups of companies are treated as a single entity and, if the group as a whole satisfies the qualification criteria, then the group must participate. The extent of a group is determined by the definition of undertaking in s.1161(1) of the Companies Act 2006, extended to include unincorporated associations carrying on charitable activities, and a group undertaking is determined by reference to s.1161(5) of the Companies Act 2006. Only the UK members of the group are caught and so for groups with overseas holding companies, the group must nominate a member of the group to be primarily responsible for compliance with the CRC. For UK groups, the highest parent company is responsible for compliance. Each member of a group required to participate is jointly and severally liable with each of the other members pursuant to the CRC Order.

Significant Group Undertakings ("SGU") were required to participate in the CRC in the first phase, but for the initial and subsequent phases, the concept of SGUs has been removed and the concept of a Participant Equivalent (PE) has been introduced. A PE is categorised as a single undertaking which is a member of a participant that is large enough to qualify for registration pursuant to the CRC in its own right. Organisations will have to report on PEs at registration and in CRC reporting.

From April 1, 2014, each organisation required to participate in the CRC must report on its consumption of electricity and gas supplies (where gas is used for heating and where it exceeds 2% of their overall electricity consumption in the first year of the phase).

This is then converted to tonnes of CO_2 using published conversion factors and this determines the amount of allowances that must be submitted.

Certain exemptions apply to the requirement to submit allowances. These include emissions covered by climate change agreements and emissions from installations covered by the EU emissions trading scheme.

For the first phase, where a participant in the CRC generates its own electricity then, provided that it has not claimed Renewable Obligation Certificates (ROCs) or Feed-in Tariffs (FITs) in respect of that electricity a credit is given in respect of that electricity thus reducing the number of allowances to be submitted.

For the next phase, which commences on April 1, 2014, and onwards, the government have confirmed that the electricity generating credit will cease to exist under the CRC. The Department of Energy and Climate Change have published a consultation proposing that a participant who generates its own electricity will have a choice between receiving a subsidy under the Renewables Obligation or FITs, or reduce its liabilities under the CRC.

Generally, if an entity is required to participate in the CRC then it must participate for the whole of a phase unless the administrator cancels their registration. Where a participant leaves a group and does not register as a separate participant from the group in a subsequent phase; or the group no longer requests that it is a separate participant in a subsequent phase, then the administrator must cancel the registration of the participant who has left the group. Where the registration of a participant is cancelled, the compliance account must be closed and the administrator must cancel any allowances held in the account immediately prior to its closure.

Allowances are valid for the year in which they are issued and any subsequent year except that an allowance issued in a phase is not valid in respect of CRC emissions made in a subsequent phase. Therefore, allowances purchased in the first phase cannot be carried forward since they are issued at a fixed price which is expected to be considerably lower than the price that will be set in future phases.

Failure to surrender allowances attracts a penalty of £40 per tonne of CO_2 and the failure may be published thus having some reputational impact.

In addition to the requirement to submit allowances, participants must submit various reports and information. For the first phase, this included a "footprint report" (reporting on energy usage in the first year of a phase and which energy consumption is to be covered by the CRC) and a "residual measurement list" (ensuring that a participant reported on at least 90 per cent of its energy usage) and an annual report. Participants must also maintain records and permit the administrator to audit those records.

There are both civil and criminal penalties for failures to comply with the requirements of the scheme.

27.1 Corporate Aspects of the CRC—overview

The CRC applies to undertakings and group undertakings.

For the purposes of the CRC, an "undertaking" and a "group undertaking" are defined by reference to ss.1161 and 1162 of the Companies Act 2006.

In respect of each phase, an organisation must determine the extent of its group on the qualification day for the relevant phase. For the first phase, the qualification day was December 31, 2008. For subsequent phases the qualification day is the March 31 of the qualification year. An organisation must participate in a phase if it meets the qualification criteria for that phase. Where a group exists, the highest parent company in the group should register as a single participant.

In the majority of cases, the extent of a group will be assessed by reference to voting rights attached to share ownership. However, in the absence of sufficient voting control to determine whether a particular undertaking can be said to be a subsidiary of another, regard will be had to the other control tests under s.1162(2) and (4) of the Companies Act 2006. In particular, whether one undertaking has the power to exercise a dominant influence over another will be relevant.

27.2 Joint and several liability

Article 8(2) of the CRC Order imposes joint and several liability on each member of a group so that each undertaking within a group may be liable for CRC compliance failures by any other member of a group.

It may be possible to limit the extent to which group members are jointly and severally liable for each other by splitting a group for CRC purposes.

27.3 Disaggregation

For the first phase, a Significant Group Undertaking (SGU) was an undertaking or a group of undertakings within a larger group which met the qualification criteria independent of the larger group. In these circumstances, the CRC permitted the SGUs to participate in the scheme separately from the larger group provided that the remainder of the group continued to meet the qualification criteria without the SGU. This division is known as "disaggregation" and in order to disaggregate an SGU, organisations had to submit an application as part of the registration process for a phase.

For the initial and subsequent phases, pursuant to the CRC Order 2013, there is now no minimum threshold for disaggregation and the principle of SGUs has been removed. Instead, a group can disaggregate any subsidiary undertaking, as long as it is not or does not include the highest parent undertaking.

27.4 Overseas companies

If the highest parent organisation of a group is an overseas company then it must nominate a UK based group member to be responsible for compliance with the scheme.

27.5 Private equity funds

The same rules apply to private equity funds as to any other corporate group and the fund may be liable for the emissions of the investee companies.

27.6 Acquisitions and disposals

Generally, any acquisition or disposal of a group company will not affect responsibility for CRC compliance during a phase. The exception is an acquisition or disposal of an SGU or a subsidiary undertaking registered in its own right as a participant. The effect of such an acquisition or disposal depends on whether the transaction occurs pre or post the relevant qualification period. CRC compliance should feature as part of the due diligence in any corporate transaction, including ensuring that allowances have been purchased and, where an SGU or subsidiary undertaking is being acquired and responsibility for compliance transferred, that those allowances are transferred to the purchaser. CRC notification of changes should feature in any post completion checklist.

27.7 Franchises

A franchisor is responsible for the emissions of its franchisees even if the franchisee is a member of another group. An exception to this is if the franchisee is a tenant and the landlord contracts for and takes a supply of electricity, in which case the landlord is responsible.

27.8 Landlord and tenant

In determining whether an organisation meets the qualification criteria relating to consumption of electricity, it is necessary to determine who is the signatory to the electricity supply agreement and who receives a supply under that agreement. If a landlord contracts for the electricity, takes a supply under that contract and meets the other qualification criteria, it will be required to participate in the scheme and will be responsible for the emissions of its tenants. The terms of the lease may not permit these costs to be passed on to the tenants and so the landlord will have to find other ways of incentivising tenants to reduce energy usage.

27.9 Annual reporting

The CRC obliges participants to produce an annual report on its CRC emissions by the last working day of July in each year of a phase.

The government has previously published a league table setting out how participants have performed in the CRC. The CRC annual report was used to identify the extent to