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KPMG INTERNATIONAL

Taxation of Cross-Border Mergers and Acquisitions

Jersey

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Jersey

Introduction

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

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

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

On 1 January 2009, Jersey introduced the zero/ten tax system for companies. Under this regime, exempt companies were abolished and revised corporate income tax rates were introduced, which depend on the activities of the company. The general rate of corporate income tax is now 0 percent. The rate of corporate income tax for certain companies with permanent establishments in Jersey and regulated by the Financial Services Commission is 10 percent. The rate of tax for utility companies and companies that receive rental income or property development profits from properties in Jersey is 20 percent.

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

Recent developments

The EU Code of Conduct on Business Taxation Group assessed Jersey's zero/ten tax system in 2011. The assessment found that the interaction of the zero percent rate and the deemed dividend and full attribution provisions to be harmful. The dividend and attribution provisions sought to assess Jersey resident individual shareholders on the profits of Jersey companies subject to the zero percent rate. As a result of the assessment, legislation was passed to abolish the deemed distribution and full attribution taxation provisions for profits arising on or after 1 January 2012, thereby removing the harmful element of the regime. The EU Code of Conduct on Business Taxation Group accepted Jersey's position and submitted to the EU's Economic and Financial Affairs Council (ECOFIN) that Jersey had rolled back the harmful tax measures and that the remaining zero and ten percent tax rates are compliant with the Code of Conduct. ECOFIN formally approved the regime on 19 December 2011.

In 2008, the island introduced a goods and services tax (GST) to make financing public services less dependent on direct taxation. The GST regime operates in a similar manner to the UK's value added tax (VAT) regime. The standard GST rate increased to 5 percent (from 3 percent) on 1 June 2011.

Asset purchase or share purchase

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

Purchase of assets

The purchase of assets may give rise to an increase in the base cost of those assets for capital allowances purposes. This increase is likely to affect the seller because a recapture of prior allowances is applied. Since there is no capital gains tax in Jersey, the seller can dispose of inherent goodwill

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without direct tax consequences, although the purchaser would not receive any tax relief for purchased goodwill. Additionally, historical tax liabilities generally remain with the company and are not transferred with the assets.

Purchase price

For tax purposes, the consideration paid is apportioned on a reasonable basis between the assets acquired. The purchase agreement should specify the allocation, which is normally acceptable for tax purposes, provided there is a commercial rationale behind the apportionment. No specific statutory rules affect how the purchase consideration is allocated. However, in accordance with Generally Accepted Accounting Principles (GAAP), stock would normally be valued at the lower of cost and market value. Jersey does not have its own GAAP regulation, so companies can chose to report under other GAAP regulations such as those of the UK and the US.

Goodwill

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

Depreciation

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

Tax attributes

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

Goods and services tax

In 2008, Jersey introduced a GST regime, which is similar to the UK's VAT system and could apply to a transfer of trade and assets. GST applies at the standard 5 percent rate and must be charged on the supply of goods and services in Jersey that relate to a trade carried on by a taxable person. Some types of supply, such as housing and medical prescriptions, have a GST rate of 0 percent. Others, including certain financial services, postal services and medical supplies, are exempt.

The sale of assets of a GST-registerable business is subject to GST at the standard rate. However, the transfer of a business as a going concern is outside the scope of the charge to GST, provided (among other things):

- there is no significant break in trading
- the assets are used by the purchaser with the intention of carrying on the same or similar business as the seller
- the assets are sold as part of the transfer of a business as a going concern.

No specified quantum of assets must be sold to meet the going concern standard.

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

Transfer taxes

Stamp duty of 0.5 percent is payable on Jersey land transactions up to the value of 50,000 British pounds (GBP). For land transactions of more than GBP50,000, scale rates apply up to a maximum of 5 percent. The sale of shares in a company that owns Jersey land might fall within the ambit of the Taxation (Land Transactions) (Jersey) Law. This law seeks to treat the sale of shares in a company that holds land in the same way as a land transaction.

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Purchase of shares

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

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

Tax indemnities and warranties

When the shares in a company are purchased, the purchaser takes over the company's history, including all related liabilities, known and contingent. Accordingly, the sale and purchase agreement normally includes extensive tax warranties and tax indemnities. The tax indemnity sets out the procedure for dealing with tax liabilities (both known and those subsequently arising) and assigns responsibility for preparing and agreeing the company's tax returns with the Comptroller of Taxes, including how any dispute resolution would be undertaken.

A due diligence exercise initiated by the purchaser includes a review of the target's tax affairs to understand the extent of any outstanding tax liabilities. Note that since the zero/ten tax system was introduced, certain Jersey resident shareholders are assessed on a deemed dividend (see crystallization of tax charges section later in the chapter) and the company has an obligation to report this deemed dividend to the Comptroller of Taxes. The due diligence exercise should ascertain whether this was done.

The deemed dividend regime does not apply to profits arising after 31 December 2011.

Tax losses

All existing tax losses transfer with the acquired company and can generally be offset against the future profits of that company, provided the trade does not change and other conditions are met. Brought forward losses cannot be offset against the profits of other companies in the group.

The acquisition agreement should indicate whether the purchaser or the seller has the right to use the target's pre-acquisition tax losses and whether there is to be any payment for the use of pre-acquisition tax losses by the purchaser.

Crystallization of tax charges

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

Pre-sale dividend

A pre-sale dividend is not commonly used for tax planning in Jersey. Such a dividend would create an income tax liability for Jersey resident sellers, but no tax charge arises on gains on the disposal of shares as Jersey does not tax capital gains.

Transfer taxes

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

Tax clearances

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

Choice of acquisition vehicle

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

Local holding company

A company is regarded as being resident in Jersey where it is incorporated in Jersey or where it is incorporated abroad but its business is managed and controlled in Jersey. A company incorporated in Jersey is not tax-resident in Jersey where the company is:

- managed and controlled in another country
- tax-resident in that country
- subject to a tax by that country, the highest rate of which is at least 20 percent.

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All Jersey-resident limited companies are subject to income tax on their worldwide income.

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

Foreign parent company

The foreign purchaser may make the acquisition itself. This method of acquisition does not affect the Jersey company's tax position. Note also that no withholding tax (WHT) is levied on dividends or interest paid to non-residents.

Non-resident intermediate holding company

Where the foreign country taxes capital gains and dividends received from overseas, an intermediate holding company resident in another territory could be used to defer this tax. Unlike the UK, Jersey lacks a network of double tax treaties and thus has no anti-treaty shopping provisions that would restrict the ability to use such a structure solely to obtain tax benefits.

Local branch

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

Joint venture

Joint ventures can be established in Jersey through the joint venture partners either holding shares in a Jersey company or participating in a Jersey partnership (Jersey law governing general partnerships is similar to English partnership law).

The use of a general partnership could allow the joint venture partners to access initial tax losses, which could then be offset against other income, whereas tax losses arising to a company cannot be used by the joint venture partners. However, the liability of each partner in a general partnership is unlimited, so there are non-tax considerations that need to be addressed before determining the joint venture's structure.

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

Choice of acquisition funding

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

Debt

The principal advantage of debt is the potential deduction for interest costs and expenses, such as bank fees, in computing trading profits for tax purposes, as the payment of a dividend does not give rise to a tax deduction. However, to minimize the cost of the debt, there must be sufficient taxable profits against which these expenses can be offset. As the standard rate of tax for a holding company or a trading company in Jersey is 0 percent (except for certain activities), there may be no profits that are suitable for relief. Therefore, the resulting tax losses would only be available for carrying forward and offsetting against any future profits of the Jersey borrower.

In determining whether sufficient taxable profits exist, losses created in the debtor company can only be group-relieved to other group companies if they are subject to the same rate of tax; in any case, the ability to group-relieve losses is not relevant between group companies that are taxed at 0 percent.

Deductibility of interest

Jersey companies generally are not obliged to make any deduction on account of any Jersey tax from any interest payments made by the Jersey company.

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Interest payments made by a Jersey company on loans taken out to acquire a trading or a controlling interest in a Jersey company are tax-deductible as trading or management expenses. Where the person paying interest withdraws capital, the withdrawn amount is treated as a full or partial loan repayment and an amount equal to the interest on that portion of the loan is deducted from the eligible interest.

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

Withholding tax on debt and methods to reduce or eliminate it

Generally, there is no withholding tax on interest payments in Jersey.

Checklist for debt funding

- Although Jersey does not have specific transfer pricing and thin capitalization legislation, intercompany debt should be structured to ensure that it satisfies the arm's length principle.
- Consider whether the level of profits would enable tax relief for interest payments to be effective and at what rate.
- A tax deduction could be available at higher rates in other territories.
- Group relief is not available between group companies whose profits are taxed at different rates; if interest cannot be offset immediately, it can only be carried forward.

Equity

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

Hybrids

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

Discounted securities

The tax treatment of securities issued at a discount follows the accounting treatment, so the issuer should be able to obtain a tax deduction for the discount over the life of the security, again subject to the rate of tax at which the tax deduction is available. Jersey legislation does not allow for the deferral of the discount accruing where the borrower and lender are connected parties.

Deferred settlement

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

Other considerations

Concerns of the seller

The tax position of the seller is a factor in the structure of an acquisition transaction. As there is no capital gains tax in Jersey, the seller likely would want a capital gain to arise on sale, rather than, for example, extracting some of the value of the target through a pre-sale dividend that would give rise to taxable income.

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Company law and accounting

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

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

Accounting standards predominantly determine the accounting treatment of a business combination. Generally, most combinations are accounted for as acquisitions; merger accounting is only applied in certain circumstances. Merger accounting is not allowed under IFRS; all business combinations must be accounted for as acquisitions.

The relevant UK accounting standards restrict merger accounting to (and make it obligatory for) a very small number of genuine mergers and group reorganizations not involving minority interests. Genuine mergers are those in which the shareholders come together in a partnership for the mutual sharing of the risks and rewards of the combined entity and in which no party to the combination in substance obtains control over any other or is otherwise seen to be dominant in any way. Numerous detailed conditions must be met.

One of the main practical distinctions between acquisition accounting and merger accounting is that acquisition accounting may give rise to goodwill. The net assets acquired are brought onto the consolidated balance sheet at their fair values, and goodwill arises to the extent that the consideration given exceeds the aggregate of these values.

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

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

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

Group relief/consolidation

Group relief provisions apply to companies subject to tax at 0 percent and 10 percent. The provisions only allow losses to be offset from one 0 percent company to another and from one 10 percent company to another. Thus, the situation is not straightforward for groups that comprise trading companies taxed at different rates. A company must own 51 percent of its subsidiary to be eligible for group relief.

Transfer pricing

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

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Dual residency

Jersey's rules regarding dual residency were updated in 2007. Subject to certain conditions, a Jersey-incorporated company managed and controlled outside Jersey, for example, in the UK, is treated as being solely tax-resident in the UK. There is no advantage or disadvantage to a company being dual resident under the Jersey tax regime.

Foreign investments of a local target company

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

Mergers

It is possible for two Jersey incorporated companies to merge into a single entity and for a foreign company to merge with a Jersey company. When two companies merge, the merged company assumes the tax liabilities of both merging companies.

Comparison of asset and share purchases

Advantages of asset purchases

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

Disadvantages of asset purchases

- GST at 5 percent may be payable.
- Tax losses remain with the seller and cannot be used by the purchaser.
- Possible need to renegotiate supply, employment and technology agreements, or to renew licenses.
- A higher outlay may be required if no liabilities are included in the purchase.
- No tax relief is available for the amortization of goodwill.
- May be unattractive to the seller since a disposal of shares would be tax-free, so the price may be higher.
- Higher transfer taxes usually arise.

Advantages of share purchases

- Tax losses remain available to be used against profits of the same trade.
- No GST on a transfer of shares.
- No stamp duty is payable on a transfer of shares.
- Capital outlay may be lower as net assets are acquired.
- Likely more attractive to the seller as Jersey has no capital gains tax.
- Less need to renegotiate contractual arrangements unless change of control provisions apply.

Disadvantages of share purchases

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

Double taxation

Jersey has double taxation arrangements in place with the UK, Guernsey, Estonia, Hong Kong, Luxembourg, Singapore, the Isle of Man, Malta and the States of Qatar. Jersey also has limited agreements with Australia, Denmark, Faroes, Finland, France, Germany, Greenland, Iceland, New Zealand, Norway, Poland and Sweden.

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Jersey – Withholding tax rates

This table sets out reduced WHT rates that may be available for various types of payments to non-residents under Jersey's tax treaties. This table is based on information available up to 10 February 2014.

Source: International Bureau of Fiscal Documentation, 2014

	Dividends[1]		Interest[2] (%)	Royalties[3] (%)
	Individuals, companies (%)	Qualifying companies (%)		
Domestic rates				
Companies:	0	0	0	0
Individuals:	0	N/A	0	0
Treaty rates				
Treaty with:				
Estonia	0	0	0	0
Guernsey	0	0	0	0
Hong Kong[4]	0	0	0	4
Isle of Man	0	0	0	0
Malta	0	0	0	0
Qatar	0	0	0	5
Singapore	0	0	12	8

Notes:

1. Under domestic law, there is no withholding tax on the payment of dividends to a non-resident company.
2. Under domestic law, there is no withholding tax on the payment of interest to a non-resident company.
3. Under domestic law, there is no withholding tax on the payment of royalties to a non-resident company.
4. Effective from 1 January 2014 (for Jersey) and from 1 April 2014 (for Hong Kong).

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Designed by Evalueserve.

Publication name: Jersey – Taxation of Cross-Border Mergers and Acquisitions

Publication number: 131036

Publication date: May 2014