

BUSINESS ACQUISITIONS

Taxation (UK) & Reporting (IFRS)

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INTRODUCTION

The tax and accounting consequences of an acquisition mainly depend on who is selling, what is being acquired and how the acquisition cost is paid and financed. This article explains the principal UK tax and IFRS reporting issues that affect the vendor's net proceeds, the acquirer's net financing cost and the acquirer's reporting of the acquisition, all of which need to be resolved before the sale is agreed.

This article discusses:

- the UK tax treatment for a UK tax resident individual or company selling shares in a UK resident company to an acquirer (tax on gains) and a UK tax resident company acquiring shares in a company resident for tax purposes in the UK or overseas (tax on loan finance and cross border remittances);
- international accounting standards that apply to a company that acquires control of another company and finances the cash component of the acquisition cost with debt (the focus is on a UK company acquiring a UK or overseas company).

It is a companion article to 'Business Acquisitions: Evaluation & Financing', which considers domestic and cross-border acquisitions from a corporate finance, financial risk and insolvency perspective. This article is structured as follows:

1 Part 1: Domestic acquisitions:

○ Vendor:

- Selling the company:
 - UK taxation on chargeable gains:
 - taxation of consideration receivable by a UK vendor, including taxation of contingent deferred consideration (earn-outs);
 - availability of capital gains reliefs under the share-for-share exchange and reorganisation rules when non-cash consideration is received;
 - exemptions and tax rate reliefs available for vendors, whether a company (Substantial Shareholding Exemption) or individual (Business Asset Disposal Relief).

○ Acquirer:

- Taking control of the domestic company:
 - IFRS reporting of control:
 - recognition of a business combination under the 'acquisition method' of accounting, when control is obtained, in one acquisition or via a series of 'step-acquisitions', and a target company becomes a subsidiary of the acquirer / parent;
 - the criteria used before recognition and measurement of the target's assets and liabilities can occur, including adjustments to assets for 'impairment';

- the preparation of group accounts incorporating the results and fair value of the subsidiary's net assets via consolidation;
 - the recognition of goodwill as the excess of consideration paid over the acquisition date fair value of net assets acquired (assuming a 100% holding).
 - recognition of deferred tax and its effect on goodwill
- Financing the acquisition:
 - IFRS reporting of financing:
 - recognition and measurement of loans obtained to finance the cash component of the consideration and derivatives used to manage interest rate risk;
 - UK tax treatment of financing:
 - the availability of tax relief for interest paid on debt securities issued to the vendor as consideration, as well as interest paid on loans to finance the cash consideration;
 - the restrictions on loan interest tax deductions (Corporate Interest Restriction, Loans for Unallowable Purpose rules).

② Part 2: Cross-border acquisitions:

- Taking control of the overseas company:
 - IFRS reporting of control:
 - consolidation of foreign operations where a subsidiary has a different 'functional' currency to the acquirer.
- Financing the acquisition:
 - IFRS reporting of financing:
 - recognition and measurement of loans denominated in the currency of the cash component of the consideration;
 - recognition of transactions that manage currency risk with derivatives.
 - UK tax treatment of financing:
 - tax residence and its implications for the acquirer and target company, particularly post-acquisition remittances from the target to its new UK parent;
 - the use of overseas intermediate holding companies to acquire the company and how debt finance can be structured;
 - international anti-avoidance rules relating to transfer pricing, hybrid mismatches, Controlled Foreign Companies.

Appendices give examples of taxation on share exchanges & conversions, tax on earn-outs and restrictions imposed by the Corporate Interest Restriction rules.

¹ This paper is derived from two papers that discussed Consideration and Financing, originally published on 21 July 2026 and 4 August 2026, now updated to include overseas acquisitions.

VENDOR

UK TAX ON CAPITAL GAINS

Chargeable Persons & Assets

A chargeable person is the beneficial owner of the asset disposed of wherever that asset is situated, who is UK resident at any time in the disposal tax year [s1A TCGA 1992] (non-UK resident persons are taxed on certain UK property and business branches or agencies).

All forms of property are assets for the purposes of TCGA 1992, including options, debts and 'incorporeal property' [s21 TCGA 1992], subject to some exceptions.

Consideration

There is no statutory definition of 'Consideration' in the Companies Act 2006 (despite being mentioned 197 times) although s583 defines 'cash consideration' (which is just one component of the 'bundle' of rights that could be included in an offer). Similarly, there's not much in the eight main UK business Tax Acts: the word appears more than 1,950 times on 8,721 pages. It has been described as 'some right, interest, profit, or benefit accruing to the one party, or some forbearance, detriment, loss, or responsibility, given, suffered, or undertaken by the other' [Currie v Misa (1875) LR 10 Ex 153] and 'the price for which the promise of the other is bought, and the promise thus given for value is enforceable'. [Pollock '*Principles of Contract*' 1876]. However one defines it, in a business acquisition it represents contractual instruments that enable the transfer of legal ownership of an entity from vendor to acquirer. It may therefore take a variety of forms: cash, shares (ordinary or preferred), loan notes, deferred consideration, non-cash assets.

For the purposes of the taxation of capital gains, consideration will include money and 'money's worth', as well as the capitalised value of any rights to receive benefits (which is relevant for earn-outs) or right to be released from liabilities. If the acquirer assumes debt owed by the vendor as part of the disposal, this will form part of the consideration [Cooling v HMRC 2015 TC04416].

The market value at the disposal date will generally replace actual proceeds for disposals between connected persons, except if specific no-gain/no-loss provisions apply (such as qualifying spouse/civil partner and intra-group transfers) [s17-18 TCGA 1992].

Any part of the sale consideration deemed to be chargeable as income will be excluded from the chargeable gain calculation [s37 TCGA 1992]. This is also relevant for earn-outs when considering if the Employment Related Securities rules apply.

Net Gain / (Loss)

A chargeable gain on the disposal of a chargeable asset will be calculated on the disposal proceeds (net of incidental costs of sale) in excess of the allowable expenditure (generally, the market value on 31 March 1982 if the asset was acquired before that date or the cost of acquisition and enhancement, and related incidental costs, since that date) [s38 TCGA 1992]. For companies, allowable expenditure may attract an indexation allowance for inflation up to 31 December 2017; indexation relief for individuals was abolished for disposals on or after 6 April 2008 [s53-55 TCGA 1992]. Total gains less total capital losses arising on disposals in the tax year are added to produce a net gain; for individuals, total net gains are reduced by the annual exemption (£3,000 for 2026-27).

A net capital loss will arise if losses exceed gains (indexation cannot increase or create a loss). Normally, subject to specific exceptions, including earn-out loss provisions discussed below, a capital loss can only be carried forward for offset against future years (s1, s2A TCGA 1992), however this is restricted for companies under the rules in CTA 2010 [s269ZBA]. It is also restricted where the parties to the sale are 'connected': the capital loss can only be offset against other gains on disposals made to that same connected party acquirer [s18 TCGA 1992]. Share Loss Relief allows individuals to offset a qualifying loss against income in that year or the prior year, subject to capping rules and eligibility conditions (for example, the shares must be subscribed for in a qualifying private trading company). Relief is also available for non-trading investing company shareholders [s131-151 ITA 2007, s68-90 CTA 2010].

Tax Charge

For individuals (2026-27), the net gains after allowable losses (after the annual exemption) are stacked above taxable income and taxed at 18% to the extent they fall within the unused basic-rate band (max {0, £37,700 - taxable income after the personal allowance}), and 24% on the remainder [see <https://www.gov.uk/capital-gains-tax/rates>].

Gains would form part of a company's taxable profits, taxed (2026-27) at 25% (a 19% small profits rate applies where profits do not exceed £50,000, with marginal relief between £50,000 and £250,000; both limits being reduced where there are associated companies).

Reliefs

Some assets are exempted from gains entirely. These would include the following:

- Where a person (natural and legal, both incorporated and unincorporated, under sch.1 Interpretation Act 1978) incurs a debt to another person, no chargeable gain will arise on the disposal of that debt by the original creditor, unless it is a 'Debt on a Security' [s251 TCGA 1992], generally taken to mean debts that are capable of being marketable, held as an investment and realised for a profit (but is not defined in the legislation) [see HMRC CG53420].

- Where Qualifying Corporate Bonds ('QCBs') are disposed of, no chargeable gain arises [s115 TCGA 1992] – see below.

Some disposals are exempted from gains entirely. These would include cases where a company disposes of a holding of shares and certain conditions as to ownership and the investee company are satisfied under the Substantial Shareholding Exemption ('SSE' – discussed below).

Some disposals are not exempted but: (1) are deemed not to be disposals (e.g. share capital reorganisations and exchanges), (2) are taxed at lower rates (e.g. Business Asset Disposal Relief / 'BADR' for individuals) or (3) are deferred ('held over') until some future event occurs. The last category effectively puts the acquirer 'in the vendor's shoes', treating both parties as the same, and would include (all references to TCGA 1992): inter-spouse transfers, s139 reconstructions involving the transfer of a business, and s171 intra-group asset transfers (that become taxable on certain 'de-grouping' events).

Form of Consideration

Cash

Consideration received wholly in the form of cash will crystallise a tax on any gain at the disposal date under normal gains rules. Deferred consideration will be taxed upfront at the disposal date, even if it is contingent (if the consideration is unascertainable, as in an earn-out, there will be a charge at the disposal date and during the deferral period – see below).

Shares → Shares

If the acquirer purchases the vendor's (individual or company) shares (or debentures) in a company ('target') in exchange for issuing to the vendor new shares (or debentures), as a result of which the acquirer will hold more than (1) 25% of the Ordinary Share Capital of the target ('Case 1') or (2) 50% of the voting power of the target ('Case 3') (or makes a general offer that would give the acquirer control – 'Case 2'), the transaction will be treated as a reorganisation of the target's share capital [s126-s131, s135 TCGA 1992].

Ordinary Share Capital is defined in s1119 CTA 2010 (and s989 ITA 2007) as 'issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits' (for example, a fixed-rate preference share, but see HMRC CTM00514).

Under s126 TCGA 1992, the reorganisation applies if a person is allotted shares in (or debentures of) a company 'in respect of and in proportion to (or as nearly as may be in proportion to) their holdings of shares or any class of shares in that company'. The following should fall under s126: a bonus or rights issue; a share consolidation; a reduction of non-redeemable share capital; or a reduction of redeemable share capital via the issue of shares or debentures.

The effect of s126 is that the transaction will not be treated as a disposal for gains purposes and the old and new shares will be treated as the same asset [s127 TCGA 1992], so that the cost of the new shares on any subsequent disposal will be the base cost of the old shares (plus consideration paid for the new shares, without indexation – s128, s131 TCGA 1992).

If any consideration (such as cash) is received in addition to the new shares, this is treated as a part disposal of the old shares and taxed as if it was a capital distribution, with a gain based on the consideration received less an apportioned amount of the original base cost. (A 'small' distribution - usually taken to be 5% or less of the market value measured immediately before the distribution - is not taxed in this way but is deferred by reducing the base cost of the new shares by the consideration received - see HMRC CG57835).

This relief is only available if the exchange passes the anti-avoidance test in s137 TCGA 1992. Prior to Finance Act 2026 ('FA 2026') the requirement was that the exchange 'is effected for bona fide commercial reasons *and* does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to capital gains tax or corporation tax'. The revised wording under FA 2026 (following recent tax case rulings that went against HMRC), effective from 26 November 2025, states if 'the main purpose, or one of the main purposes, of the arrangements is to reduce or avoid liability to capital gains tax or corporation tax' HMRC can make 'just and reasonable' adjustments to the reduction or avoidance amount, or eliminate them completely. Advance clearance under s138 TCGA 1992 should normally be obtained.

Shares → QCB

'Debentures'

The s135 share for share exchange provisions discussed above also include 'debentures'. For tax purposes:

- 'there is no statutory definition of debenture....it has its ordinary meaning which is acknowledgement of debt. Nearly all debentures issued in exchange for shares and debentures will be securities....' [HMRC CG52540];
- under s251 TCGA 1992, 'a debenture issued by any company on or after 16th March 1993 shall be deemed to be a security if it is issued in exchange for shares in or debentures of another company and in a case to which section 135 applies....';

'QCBs'

QCBs are defined as:

- for corporation tax purposes an asset that represents a 'Loan Relationship' [Parts 5 and 6 s292-569 CTA 2009] will be a QCB [s117(A1) TCGA 1992];

- for purposes other than corporation tax (including individuals and trustees), a QCB is a corporate bond which is qualifying (broadly, issued after 13 March 1984, subject to the exception for 'deeply discounted securities' [s117(7)(a), s117(2AA) TCGA 1992])

A 'Corporate bond' must meet all of the following conditions:

- it is a security, as defined in section 132(3)(b):...“Security” includes any loan stock or similar security whether of...any company, and whether secured or unsecured’;
- the underlying debt represents, and has at all times represented, a ‘normal commercial loan’ as defined under s162 CTA 2010, being one which:
 - ‘is of or includes’ new consideration
 - carries no right of conversion into shares or securities other than corporate bonds within s117 TCGA 1992
 - does not carry a right to acquire shares or securities
 - does not provide interest that depends on the results or assets of the company (subject to exceptions)
 - does not provide interest that exceeds a reasonable commercial rate of return on the new consideration lent
 - the amount repayable does not exceed the new consideration lent or is reasonably comparable with amounts repayable for quoted securities
- it is, and has at all times been, expressed in sterling (excluding sterling amounts determined by reference to the value of another currency or asset), with no provision for conversion into, or redemption in, another currency (unless the redemption amount in another currency is calculated from the sterling amount at the redemption date exchange rate).

[see HMRC CG53702P];

So QCBs and non-QCBs can be considered ‘debentures’ under s135 (they are explicitly referred to in s116).

If the vendor sells its shares in exchange for QCBs issued by the acquirer, s127-130 would ordinarily apply ‘by virtue of any provision of Chapter II of this Part’ (s126 – 140L, which includes s135), meaning the QCBs would effectively replace the shares and not be taxed on any subsequent disposal (since QCBs are exempt). To bring the gain on the shares at the date of exchange into the gains rules, s127-130 are disapplied under s116(5) TCGA 1992.

The gain is not taxed at the date of exchange but is frozen (‘held over’) until the QCBs are subsequently sold [see HMRC CG53709].

Shares → QCB + Shares

If the vendor receives QCBs and shares in the acquirer, s116 disapplies s127-130 for that part relating to the QCBs: ‘This section shall have effect in any case where ... the original shares would not [include

a qualifying corporate bond] and the new holding would consist of *or include* such a bond.....Where the qualifying corporate bond ... would constitute the new holding for the purposes of sections 127 to 130, it is in this section referred to as "the new asset" and the shares or securities which would constitute the original shares for those purposes are referred to as "the old asset".'... So far as the relevant transaction relates to the old asset and the new asset, sections 127 to 130 shall not apply in relation to it. [s116(1)(b),(4),(5) TCGA 1992].

Shares → QCB + Cash

If the vendor receives QCBs and cash, a proportion of the gain accruing on the shares at the date of exchange will be taxed (the proportion being cash received as a percentage of the market value of the shares at the date of exchange), with this amount being deducted from the final gain when the QCBs are disposed of or redeemed. If the cash element is 'small', this provision is ignored (see above).

Shares → Non-QCB

If the vendor sells its shares in exchange for non-QCBs (for example convertibles), s127-130 would apply and not be disapplied by s116 (which requires QCBs to be part of the exchange), meaning the treatment is the same as for a share-for-share exchange.

QCBs ↔ Non-QCB or Shares

If the vendor holds securities in the target company (along with shares), any part of the gain relating to the QCB must be ignored in the calculation of a gain when the new asset is disposed of. If QCBs are exchanged for non-QCBs, s116 disapplies s127-130 and effectively re-sets the base cost for the non-QCBs as the market value of the QCBs at the exchange date. If the situation was the other way round, this would be treated as for the Shares → QCB case above (there is no deemed disposal and the gain on the non-QCB at the exchange date is held over and taxed when the QCB is redeemed or otherwise disposed of).

See [Appendix 1](#) for an example where the vendor exchanges shares, QCBs and non-QCBs in a company for cash and shares, QCBs and non-QCBs issued by the acquirer.

Timing of Consideration

General Treatment

The date of disposal under contract for the purposes of taxing capital gains in the UK on the sale of shares (Capital Gains Tax for individuals, Corporation Tax for companies [s1-2 TCGA 1992]) will be the date of contract (unconditional contract) or the date when all conditions have been satisfied (conditional contract) [s28 TCGA 1992].

If consideration is deferred and ascertainable (whether or not contingent), the whole of the sale proceeds will be taxed upfront at the disposal date, including the deferred consideration (no discounting for the deferral period time value or risk is permitted) [s48 TCGA 1992].

If any part of the consideration 'proves to be irrecoverable', a claim can be made to recover the overpaid tax. If the deferred consideration is not ascertainable at the date when the right to such consideration is conferred, as in an earn-out arrangement, the tax treatment would follow the principles set down in *Marren v Ingles* (1980) 54 TC 76. The deferred consideration would be unascertainable at the disposal date if the amounts depend on events that have yet to occur [HMRC CG14940, s279B(3) TCGA 1992]. If the amounts are fixed or determinable at the disposal date, for example, if they related to performance before the sale date, they will be ascertainable.

Taxation of Earn-outs in Sale Agreements

Cash Earn-outs

In an Earn-out, the amount received at the disposal date and the value of the future earn-out rights paid wholly in cash are taxed in full at the disposal date. Under *Marren v Ingles*, the value of the earn-out rights is a separate asset to the shares being sold ('chose in action'). The right to receive an earn-out payment is contingent on future events, and can be determined using techniques to estimate the present value of contingent payoff cash flows. The fair value of the earn-out rights at the disposal date is added to the cash consideration paid at the disposal date to give total consideration used to calculate the upfront chargeable gain. A chargeable gain calculation is then performed at each future earn-out payment date to determine the gain for the part-disposal of the earn-out right.

Assuming cash consideration of C_0 is paid at the disposal date (t_0) and there are three future earn-out payments at t_1 , t_2 and t_3 equal to C_1 , C_2 and C_3 , which have a disposal date fair value of V_0E (calculated using PV valuation techniques discussed below), the gain at the disposal date would be equal to $C_0 + V_0E - \text{base cost of shares}$. At the date of the first earn-out payment C_1 , the fair value of the remaining payments C_2 and C_3 would be re-calculated (V_1E). The gain at t_1 would equal $C_1 - B_1$, where B_1 is the 'base cost' of the initial earn-out right (V_0E) that is apportioned to C_1 using a part disposal formula, treating all earn-out rights as a single asset ($B_1 = V_0E \times C_1 / (V_1E + C_1)$). The gain at t_2 would reduce the base cost by the amount allocated to C_1 , so the gain would equal $C_2 - \{ (V_0E - B_1) \times C_2 / (V_2E + C_2) \}$.

See [Appendix 2](#) for an example of UK taxation of a cash earn-out.

Security Earn-outs

Rather than receive future earn-out consideration wholly in the form of cash, the vendor may receive shares or securities issued by the acquirer (with or without a cash component). If these were issued at the date of disposal without any earn-out, they might qualify for the s135 reorganisation / exchange relief. Since earn-out rights are separate assets to shares, this relief would not be available for these security earn-outs unless special rules existed. S138A TCGA 1992 allows earn-out rights that are

satisfied wholly by issuing shares / debentures to be treated as securities, so that the share reorganisation rules can apply, subject to certain conditions being met.

These conditions are (see HMRC CG58015):

- the earn-out arrangement meets the definition given in s138A, including a requirement that the unascertainability of the value of the earn-out shares / debentures relates to a relevant company (the issuing company or the company taken over, and any company in the same capital gains group as either of these entities);
- no cash earn-out payments can be made, only shares / debentures; and
- the exchange satisfies all the conditions in s135 on the assumption that, hypothetically, it did not involve a security earn-out.

An election can be made to disapply s138A, meaning the earn-out would be treated as for cash earn-outs, without any opportunity to benefit from the no-disposal rule in s135 exchanges. Where s138A applies and no election is made to disapply it, the deemed earn-out security is 'incapable of being a qualifying corporate bond' [s138A(3)(b) TCGA 1992], the basic share-for-share s135 exchange rules would apply (without involving s116, which deals with QCBs).

Tax issues for earn-outs

A vendor will want to ensure amounts received under the earn-out are taxed in the manner they would prefer and that they can still benefit from any available reliefs. If an owner-manager vendor remains involved in running the business disposed of (for incentivisation reasons), there may be a risk that security earn-out rights (where there is no option to receive cash) are made 'available by reason of an employment', including former or prospective employment, and taxed as securities options under the Employment Related Securities ('ERS') rules [s421B, s417-554 ITEPA 2003]. ERS are treated as 'Specific Employment Income' [s6, s7 ITEPA 2003], taxed under the income tax rules (and higher rates) and would require employer National Insurance Contributions to be paid. The terms of the earn-out agreement must reduce the risk of this income treatment by ensuring the earn-out rights are taxed as additional consideration for the disposal of the shares and cannot be seen as arising by reason of employment. Guidance is given at HMRC ERS110940.

The IFRS reporting of an acquirer's liability to pay contingent earn-out consideration is discussed below.

Exemptions and Reliefs

Business Asset Disposal Relief (BADR)

BADR is available for qualifying business disposals by individuals, including the 'material' disposal of a business asset [s169H – s169V TCGA 1992]. This would include the disposal of shares or securities in a trading company where, throughout the 2 year period ending with the date of disposal: [A] the

company was the individual's 'Personal Company' in which they: (1) held at least 5% of the Ordinary Share Capital (as defined above for share-for-share exchanges) and voting rights, (2) were beneficially entitled to at least 5% of (i) the profits available for distribution to equity holders and assets on a winding up or (ii) proceeds on the disposal of the whole of the ordinary share capital; and [B] the individual is an officer or employee of the company.

BADR also includes cases where a sole trader disposes of the whole or part of an unincorporated business (trade, profession or vocation) they have owned throughout the 2 year period ending with the disposal, but is limited to gains on 'relevant business assets' used in the qualifying business (this would include goodwill, unless the business is sold to a Close Company under certain conditions).

The BADR tax rate advantage has been reduced to 6% for disposals from 6 April 2026 (18% BADR rate vs. 24% higher rate CGT rate), reducing the saving to £60,000, assuming the £1m lifetime gain cap was used up in one year.

Individual vendors who would otherwise obtain a capital gains tax reduction under BADR rules, cannot benefit from the lower rates in respect of subsequent gains on cash earn-out payments, since these are in respect of the earn-out right and not the shares (it would be available on the amount charged at the disposal date, being the cash consideration plus fair value of the earn-out).

Substantial Shareholding Exemption (SSE)

A corporate vendor can obtain full exemption from corporation tax arising on chargeable gains on the disposal of shares or an interest in shares (e.g. a joint interest) in a trading company (or holding company of a trading group) if certain conditions are met and anti-avoidance traps avoided (any capital loss would be disallowed) ['the main exemption' in s192A, para. 1 Sch.7AC TCGA 1992]. The main requirement is that throughout a 12 month continuous period, beginning not more than 6 years before the disposal date, the vendor held shares or an interest in shares that gave it beneficial entitlement to at least a 10%: (1) holding of the ordinary share capital, (2) share of profits available for distribution to equity holders and (3) entitlement to assets on a winding up. The shares disposed of do not need to be part of this holding (they could be preference shares), and the 10% interest does not need to be held at the date of disposal (it could be held up to 5 years before the disposal).

If an acquirer wished to acquire some but not all of the assets used in a trade held by the target (or avoid liabilities), the target could transfer these 'sideways' to a newly formed wholly owned subsidiary of the vendor ('newco') before the vendor sold the shares in newco to the acquirer. The transfer would be tax neutral under the rules in s170-181 TCGA 1992, as the target (transferor) and sister newco (transferee) are part of the same chargeable gains group (broadly comprising a 75% interest in subsidiaries). The transfer of the trade would be treated under the corporation tax succession rules in s940A CTA 2010 (which deals with the continuation of capital allowances and loss availability). An alternative 'Hive-Down' approach would be the target transferring 'down' to a newly formed wholly owned subsidiary, before it sold that newco to the acquirer (the proceeds would be distributed tax free to the vendor, unless the vendor wanted them to remain in the target for reinvestment purposes - so

this method adds some complexity). Stamp Duty Land Tax rules would need to be considered for the hive-down and 'sideways' transfer.

If the transferee (newco) leaves the group within 6 years of the date of receiving an asset on a no-gain / no-loss intra-group transfer, a 'degrouching' charge may arise if it still holds the asset [s179 TCGA 1992]. This gain is, broadly, calculated on the assumption the asset was sold and immediately re-acquired at the transfer date at market values [s179(3) TCGA 1992]. If a group company sells its shares in newco, the degrouching gain is added to the seller's consideration for those shares [s179 (3D)(a) TCGA 1992], however if the share disposal qualifies for SSE, the exemption applies to the gain on sale and degrouching [s179(3A) TCGA 1992, para.1 Sch.7AC TCGA 1992]. (Similar rules apply to the intra-group transfer of intangible assets [s764 – 799 CTA 2009]).

The setting up of newco will not affect the SSE 12 month continuous holding period requirement since para.15A Sch. 7AC TCGA 1992 can extend the qualifying holding period by reference to the previous use of the transferred trading assets within the group. See HMRC CG53080C.

As for BADR, the SSE will not apply to the later gain on cash earn-out payments, since they are not in respect of shares, but are disposals or part-disposals of the separate earn-out right.

ACQUIRER

TAKING CONTROL OF THE BUSINESS

REPORTING THE DOMESTIC ACQUISITION

Introduction to Business Combinations

The recognition of consideration paid to acquire a company in the financial statements of the acquirer prepared under IAS will depend on how the acquisition is accounted for. Under IFRS 18 (mandatory for accounting periods commencing on or after 1 January 2027), the statements would include a statement of financial performance for the reporting period (a Profit or Loss Account / 'P&L' and Other Comprehensive Income / 'OCI'), a statement of financial position as at the end of the reporting period (Balance Sheet / 'BS'), a statement of changes in equity for the reporting period and a statement of cash flows for the reporting period (and notes).

A Business Combination ('BC'), where an acquirer obtains 'control' of the target and the acquired activities constitute a business, will be accounted for under IFRS 3 using the 'Acquisition Method' and consolidated as a subsidiary under IFRS 10. If the acquirer has 'significant influence' (the power to participate in the financial and operating policy decisions of the investee) but not control (usually voting rights of at least 20%), the 'Equity Method' will be used [IAS 28], when the investment is recognised as a single line in each statement.

Control

Control of the investee is achieved under IFRS 10 if:

- the investor is exposed, or has rights, to variable returns from its involvement with the investee that depend on the investee's performance (dividends, changes in the value of the holding, residual interests in net assets on liquidation, fees etc); and
- the investor has the ability to affect those returns through its power over the investee (existing 'substantive' rights that give the current ability to direct the activities that significantly affect the investee's returns, taking into account the size of voting rights relative to other holders, potential voting rights – for example via options and convertibles - and non-shareholder contractual voting rights).

Normally, a holding of more than 50% of the voting rights would give the required level of power (but a holding of less might also give 'de facto' control).

[§ 6-7, App.A, B2, B37, B42, B46 IFRS 10]

Consolidation

Control requires presentation of consolidated financial statements, unless an exemption applies under § 4 IFRS 10 and s399 - s401 CA 2006 (this includes cases where the ultimate parent prepares consolidated statements, subject to various conditions being met).

A subsidiary is recognised from the date of acquisition, being the date control is obtained, usually when the acquirer legally transfers the consideration, acquires the target assets and assumes responsibility for the target liabilities [§8-9, App. A IFRS 3]. Net income in the P&L will reflect post-acquisition performance of the subsidiary.

Net Assets

In Separate Financial Statements

General

In general, assets and liabilities are only recognised if:

- they meet the required definition and
- recognition provides information that is relevant and a faithful representation of the item, which would require judgement, taking into account the degree of uncertainty and probability of inflow or outflow of economic benefits occurring [§ 5.6, 5.7, 5.14 IFRS Conceptual Framework 2018].

Definition of assets & liabilities

An asset is defined as a 'present economic resource' (a right that could produce economic benefits) controlled as a result of past events [§ 4.3-4.4 IFRS Conceptual Framework 2018].

A liability is defined as a 'present obligation', as a result of past events, to transfer an economic resource: the entity has no realistic alternative to settling an obligation that arose from past 'obligating' events that create a legal or constructive obligation, where there is a valid expectation that the entity will discharge the obligation. An obligation (a duty or responsibility to another party the entity has no practical ability to avoid) need not be certain or likely (and may depend on future events occurring), but does need to be 'present' and exist because the entity has already obtained economic benefits that will or may require it to transfer an economic resource [§ 4.26, 4.29, 4.37, 4.43, 4.46 IFRS Conceptual Framework 2018, §17 IAS 37].

A liability would include (1) a contractual obligation to deliver cash or another financial asset to the vendor (without any unconditional right to avoid delivering them) and (2) a contract settled by issuing a variable number of the acquirer's own equity instruments [§11 IAS 32].

A contingent liability is an obligation that arises from past events that is (1) a 'possible' obligation (that depends on uncertain future events not under the control of the entity) or (2) a 'present' obligation whose outflow is not probable or the amount cannot be measured reliably [§10, 14 IAS 37].

Recognition of assets & liabilities

Whether an asset is recognised or not depends on the requirements of the Conceptual Framework ('CF') and the relevant standard. Tangible and Intangible assets are treated slightly differently:

- A tangible asset would be recognised if:
 - it is probable that future economic benefits associated with it will flow to the company that controls it, and
 - the initial recognition amount can be measured reliably [§7, 15 IAS 16].
- An intangible asset would be recognised if:
 - the recognition criteria for tangible assets (probability and reliable measurement) are met,
 - it meets the general CF asset definition above, and
 - it is identifiable because:
 - it is 'separable' (for example it can be sold) or
 - it arises from legal rights (for example a registered patent) [§ 8,18, 21 IAS 38].

Non-contingent and contingent liabilities are treated differently. A contingent liability would not be recognised under IAS 37, but would be disclosed in the notes to the financial statements.

Measurement of assets and liabilities: fair values & impairment

If the target has adopted International Accounting Standards, it will have recognised in its financial statements assets and liabilities measured according to various rules set out in IFRS / IAS:

- An asset will start life on the balance sheet at 'Fair Value' ('FV') or cost (normally equal to FV at the date of purchase, assuming an arm's length transaction) and be 'depreciated' (tangible asset) or 'amortised' (intangible), if required, over the reporting period.
- The asset's 'Carrying Amount' ('CA') on the BS equals the Initial Amount Recognised ('IAR') less accumulated depreciation ('D'), amortisation ('A') and 'impairment' charges. For relevant non-financial assets (financial assets have separate rules), CA must be reduced to its 'Recoverable Amount' ('RA') due to any value impairment (with the current period impairment loss being charged to the P&L – impairment losses for revalued assets are treated as a revaluation decrease and offset the relevant revaluation surplus in OCI):
 - RA is the higher of its 'Fair Value Less Costs of Disposal' ('FVLCD') (selling the asset) and its 'Value-In-Use' ('VIU') (using the asset).
 - FVLCD comprises FV (discussed below) less incremental costs directly attributable to the asset's disposal (ignoring financing costs and tax)

In summary: Impairment loss = Unimpaired CA (= IAR - A – D) - Impaired CA (= RA)

[§ 6, 8, 59-61 IAS 36].

FV is a market-based measurement of the 'exit' price to sell an asset or transfer a liability in a hypothetical orderly transaction between market participants under market conditions at the measurement date in the principal market (or most advantageous market in the absence of a principal market), irrespective of whether there are observable market transactions and information [§ 2, 9, 24, App.A, BC30-BC31 IFRS 13]. For non-financial assets, the valuation would be based on 'highest and best use'. If prices are not observable in the market, a valuation technique (such as PV methods) must be used that maximises use of observable inputs and minimises use of unobservable inputs [§ 3, B2 IFRS 13].

VIU is an entity-specific measurement of value equal to the PV of future net cash flows the entity expects to receive from the asset or collection of assets in a 'Cash-Generating Unit' ('CGU') (smallest identifiable group of assets that generates cash inflows that are largely independent of cash inflows from other assets). It is estimated using 'reasonable and supportable' assumptions about economic conditions over the asset's remaining 'useful life' (the period over which the asset is expected to be used), that form the basis of the most recent management approved budgets or forecasts (max 5 years,

unless a longer period can be justified) and post-budget terminal value calculation. Financing and tax items are ignored in the cash flows being valued, so the discount rate is a pre-tax rate (see Exposure Draft comments below) [§ 6, 33, 36, 55, 59, 69, A20, BCZ45 IAS 36].

Future cash flows are estimated for the asset in its current condition, and must ignore cash flows relating to restructurings (to which management are not yet committed) or cash flows that enhance or improve the asset's performance (but see comments below regarding a proposal in a 2024 Exposure Draft to remove this restriction): the only cash flows considered are:

- cash inflows from the continuing use of the asset,
- cash outflows necessary to obtain those inflows (to maintain the level of economic benefit expected to arise from the asset in its current condition from servicing that asset) and
- cash inflows from the sale of the asset at the end of its useful life

[§ 33(b), 39, 41, 44, 45, IE56 IAS 36]

For a CGU that has assets with different useful lives, IAS 36 recognises that replacing assets is a part of the servicing of those assets (similar to replacing components in a single asset) and the capital expenditure ('capex') relating to such replacement should be included in the cash flow forecasts [§49 IAS 36]: 'The cash flows, out into the far future... must necessarily include capital expenditure as well, at least to the extent required to keep the CGU functioning as forecast. This is explicitly acknowledged in the standard...' [p.1581 EY International GAAP 2026]

A CGU VIU estimate (for financial reporting) would differ from its DCF Enterprise Value equivalent (for disposal purposes) for a number of reasons, including the following:

- Capex excludes 'growth' capex in the VIU or any other capital costs that expand the CGU beyond its current condition – all cash inflows relating to such expenditures must be ignored; a DCF would include all capex - maintenance and growth – and any related cash inflows. The terminal value in VIU would use maintenance capex. The growth vs. maintenance separation complexity has been acknowledged: 'management can find it challenging to distinguish maintenance capital expenditure from expansionary capital expenditure in these budgets or forecasts' [§4.35 IFRS Discussion Paper DP/2020/1]
- The pre-tax discount rate for VIU is not derived correctly (it is not always the post-tax rate used for a DCF grossed-up by the tax rate) [§BCZ85 IAS 36].

However, the International Accounting Standards Board ('IASB') tentatively decided (1) in July 2025 to remove the requirement to use pre-tax cash flows and a pre-tax discount rate and (2) in April 2026 to retain its proposal to remove the requirement to exclude cash flows from uncommitted future restructurings and asset enhancements [IASB update April 2026].

In Consolidated Financial Statements

General

As at the acquisition date, the acquirer recognises:

- Identifiable assets acquired and liabilities assumed Net assets ('NA') of the acquired subsidiary ($NA = \text{Assets 'A'} - \text{Liabilities 'L'}$) would be recognised at the acquisition date fair values - subject to IFRS 3's recognition and measurement exceptions - whatever the percentage shareholding, so long as control was obtained. (Deferred tax is discussed below.)
- 'Non-Controlling Interest' ('NCI') NCI represents the proportion of net assets in which the acquirer does not have an interest ($[100\% - \text{acquirer \%}] \times \text{fair value of NA}$), or the fair value equivalent of such an interest if that measurement option is chosen.
- Goodwill ('G') This equals fair value of consideration and recognised NCI less the fair value of the identifiable NA. Hence $G = C + NCI - NA$.

[§10 IFRS 3]

Recognition of assets & liabilities in a BC

When applying the acquisition method for BC, to qualify for recognition, identifiable asset and liabilities must:

- meet the definitions in the Conceptual Framework (see above)
- be part of what was exchanged in the BC rather than the result of separate transactions

[§11-12 IFRS 3]

An intangible asset is recognised in a BC if it meets the definition and recognition criteria. The probability recognition criterion for an intangible asset will always be met if it is either acquired separately or as part of a BC, because the consideration paid by the acquirer would reflect its assessment of future probability [§ 25,33 IAS 38]. To be recognised in a BC, the intangible would have to meet the definition of an intangible asset and be identifiable. If it cannot be recognised, it would simply form part of the consideration that does not relate to identifiable NA (Goodwill) [§68 IAS 38].

A contingent liability *is* recognised if acquired as part of a BC under IFRS 3, unless it is simply a 'possible' obligation. It would be recognised if it is a present obligation (as defined above), whose fair value can be measured reliably, even if it is not probable it will require settlement via the transfer of economic benefits [§22-23 IFRS 3].

Measurement of assets & liabilities in a BC

The acquirer measures the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values [§18 IFRS 3].

The requirements of IFRS 13 for fair value measurement apply to BC [§5 IFRS 13, §18, App A IFRS 3].

Consideration

Initial Recognition

The fair value of consideration given to acquire the subsidiary will include the fair value of assets transferred to the vendor (such as cash), liabilities incurred to the vendor (such as loan notes) and equity interests issued to the vendor (shares). All forms of contingent consideration are included [§37 IFRS 3], including future earn-out payments.

The form of consideration will determine how it is recognised in the balance sheet. If cash is debt financed, the liability side will reflect the debt initially at fair value. Shares issued on completion will be recognised in equity. Contingent consideration will be classified either as a liability or equity. A cash earn-out clearly meets the definition of a liability (the acquirer has a contingent obligation to deliver cash it cannot avoid). In a securities earn-out, where the future earn-out right, for example, is settled wholly by the issue of acquirer shares, the earn-out would be classified as (1) a liability if a variable number of shares will be issued for a fixed monetary amount or (2) equity if a fixed number of shares are issued whose market value fluctuates.

Estimating the fair value of contingent consideration at the date of acquisition would depend on the terms of the earn-out and the nature of the payoff (see 'Business Acquisitions: Evaluation & Financing'), but would generally require:

- an income approach valuation technique [§B10-B11 IFRS 13]:
 - payoff varies linearly with performance metric: expected present value technique [§B23-B30 IFRS 13]
 - payoff does not vary linearly due to thresholds, caps and tiered payments: option pricing technique (such as Monte Carlo simulation) [§B11(b) IFRS 13]
- maximum use of relevant observable inputs; minimal use of unobservable inputs [§3, §67, §86-87 IFRS 13]
- assumptions a market participant would use [§21-22, §40, IFRS 13]

The expected present value technique estimates expected cash flows based on the probability-weighted average of all possible future cash flows [B23 IFRS 13]. The discounting procedure involves one of the following methods that should produce the same value:

- Method 1: expected cash flows are adjusted to 'certainty equivalent' cash flows and discounted at a risk-free discount rate [B25 IFRS 13]. A 'cash risk premium' for market risk (systematic and undiversifiable) is deducted from expected cash flows before discounting at the risk-free rate.
- Method 2: expected cash flows are not adjusted but discounted at a risk-adjusted discount rate [B26 IFRS 13]. The discount rate includes the market risk premium.

The cash premium and rate premium are calibrated to produce the same present values (see Appendix 1 of the article 'Security Valuation: Option Pricing' for an example).

Post-acquisition recognition

Borrowings used to finance the cash consideration will be recognised as a liability, initially at fair value and thereafter at its amortised cost (initial eligible transaction costs will be part of the amortised cost calculation), which will not change – assuming no principal repayments - if effective interest (charged to P&L) equals actual interest paid (in the cash flow statement), ignoring foreign exchange differences (see the article 'Security Valuation: Convertible Bond Pricing' for more discussion on amortised cost). Shares issued on completion and recognised in equity will not be re-measured [§58 IFRS 3]. Contingent consideration will be recognised post-acquisition according to its initial recognition. Liability-classified contingent consideration will be remeasured at each reporting date at fair value, with any change in fair value being recognised in the P&L (equity-classified consideration is not remeasured) [§58 IFRS 3]. The initial goodwill calculation will not be affected, except for qualifying measurement period adjustments (discussed below).

Goodwill

Initial Recognition

As stated above, where the acquirer obtains 100% of the subsidiary, goodwill is calculated as the fair value of the consideration (C) less the fair value of the identifiable NA ($G = C - NA$). If less than 100% is acquired, the consideration will, indirectly, be in respect of a proportion of the NA, so NCI needs to be considered: $G = C + NCI - NA$, where NCI is either measured at fair value or as a proportion of NA. (See below for the goodwill calculation if the investor has a previous holding at the date of control).

Identifiable NA will include amounts recognised in the target's financial statements ('NA_{R1}') and those not recognised there but recognised by the acquirer as part of the BC ('NA_{R2}') (identifiable intangible assets that do not meet the pre-BC recognition criteria and contingent liabilities) [§13, 51 IFRS 3]. Some of the combined value of (1) NA not recognised at the acquisition date (NA_{NR}) and (2) the NPV of future growth investment for existing NA (recognised and unrecognised) and future NA (NPV_G), will be paid for and form part of consideration, so that for a 100% acquisition, using an illustrative decomposition:

$$\begin{array}{c}
 \text{C} \qquad \qquad \qquad \text{NPV}_A \text{ (NPV for acquirer)} \\
 \hline
 \text{G} \\
 \hline
 \text{Intrinsic Value (i.e. DCF Equity Value)} = \text{NA}_{R1} + \text{NA}_{R2} + \boxed{\text{NA}_{NR} + \text{NPV}_G}
 \end{array}$$

If the acquirer obtains control without transferring any consideration, it must still account for the transaction as a BC under IFRS 3. Goodwill would then be calculated with the fair value of the acquirer's interest in the target replacing consideration. This might arise if minority veto rights that were sufficient to prevent control lapsed [§33, 43, B46 IFRS 3].

Consideration may be paid that does not relate to the BC, but is in respect of negotiations during the transaction process (for example, the remuneration of former owners of the target for future services, as may be the case in an earn-out). These are separate obligations to the BC and should be accounted for under the relevant IFRS [§51, 52, B50 IFRS 3].

Acquisition expenses (non-financing) are charged to the P&L and are not part of the goodwill calculation. Debt or equity raised to finance the acquisition would be recognised under IAS 32 and IFRS 9. Eligible debt issue costs are reflected in the amortised cost balance; eligible equity issue costs are deducted from equity.

Post-acquisition recognition

Goodwill is initially recognised on the BS as an asset. The provisional goodwill calculation may be adjusted if new information - concerning facts and circumstances existing at the date of acquisition - is obtained about the components in its computation (this 'measurement period' starts at the date of acquisition and ends at the earlier of the date information is obtained and the date 12 months after acquisition) [§45,46 IFRS 3].

Goodwill is tested for 'impairment' annually and additionally whenever impairment indicators arise, as are intangible assets with indefinite useful lives or which are not yet available for use – all other assets are tested only if there is any indication of impairment [§ 9,10 IAS 36]. For goodwill, the recoverable amount is based on the 'Cash-Generating Unit' ('CGU') to which the goodwill relates [paras. 80-90 IAS 36]. An impairment charge is made to the P&L to reduce the carrying amount to its recoverable amount.

Deferred tax

Introduction to deferred tax

General principles

A fundamental principle of accruals based financial reporting ('Generally Accepted Accounting Practice' / 'GAAP', such as IAS and IFRS financial reporting standards issued by the International Accounting Standards Board) is that expenditure is matched with related income and both are accrued for in the

same period (booked according to the period they relate to rather than when the cash effect arises). For example, the upfront cost of acquiring an asset should be matched over time in the income statement against the periodic revenue and profits arising from the use of the asset (including its sale). This is achieved via depreciation (tangible assets) and amortisation (intangible assets). The deduction for tax purposes in respect of the cost of the asset may not equal the expense for accounting purposes due to permanent differences (amounts that are disallowed for tax purposes, just as some income might be exempt) and 'temporary' differences (mainly due to timing differences that arise when the expense is included in the accounting profit in one period but in the taxable profit in another, but can arise in other cases, such as when assets are revalued for accounting purposes but not for tax purposes). Such differences also arise for income and gains.

In the UK, a tax deduction for the cost of a tangible asset might be accelerated and arise in full in the year of acquisition or be allocated on a reducing-balance basis. Depreciation in the income statement is usually based on a straight-line allocation of the 'Depreciable Amount' (qualifying cost less 'residual value' at the end of its useful life – IAS 16 para.6) over the period during which the asset is available for use by the business ('Useful Life'). This difference is only temporary, however, as whilst in early years 'tax depreciation' is greater than accounting depreciation (taxable profit is less than accounting profit) a reversal occurs later on (taxable profit is more than accounting profit). Over the life of the asset, broadly, tax depreciation will equal accounting depreciation.

For these assets, the carrying amount in the balance sheet equals cost less accumulated depreciation, whilst the 'tax base' (on which capital allowances are based) equals cost less accumulated tax allowances. If the carrying amount exceeds the tax base, the accumulated deductions for tax purposes given so far have been greater than those for accounting purposes. When the temporary difference reverses, more tax will be payable and this should be provided for via a deferred tax liability.

Deferred tax liabilities

A deferred tax liability ('DTL') on 'taxable temporary differences' will arise on the excess of the carrying amount of an asset over its 'tax base' (tax rate expected when differences reverse $\times (A_{\text{IFRS}} - A_{\text{TAX}})$) and vice versa for a liability (tax rate $\times (L_{\text{TAX}} - L_{\text{IFRS}})$). The deferred tax charge is the increase in the liability over the period (in a Business Combination deferred tax arising on initial recognition goes to goodwill rather than P&L, as discussed below).

Deferred tax assets

A deferred tax asset ('DTA') arises where there are 'deductible temporary differences' ($A_{\text{TAX}} - A_{\text{IFRS}}$ for assets and $L_{\text{IFRS}} - L_{\text{TAX}}$ for liabilities) and where tax losses carried forward from prior periods are available to reduce taxable profits (s45 - s45D Corporation Tax Act 2010 in the UK, subject to carry forward restrictions under part 7ZA of that Act). A deferred tax asset can only be recognised if its recovery is probable and sufficient taxable profits will be available in the future to utilise the deductible temporary differences [para. 24,27-31, 34 IAS 12].

Deferred tax arising on business combinations

Temporary differences in consolidated financial statements, in respect of the business combination, are determined by comparing the carrying amount of the subsidiary's assets and liabilities in the group accounts (revalued to acquisition date fair values) to the corresponding tax base (determined by reference to its tax return) [§11 IAS 12]. For a business combination, temporary differences may arise:

- on the initial recognition of an asset or liability (there is an exemption if the net assets are acquired otherwise than in a business combination) [§15, 24 IAS 12];
- on revaluation to acquisition date fair values, if no corresponding adjustment is made to the tax base [§18(a) IAS 12].

If a DTA or DTL arises on a business combination, it will be recognised as an identifiable asset or liability and will therefore affect the goodwill calculation. A DTL will reduce the fair value of identifiable net assets acquired, increasing goodwill. A DTA can only be recognised to the extent it is probable a taxable profit will be available for utilisation.

No DTL is permitted to be recognised on the initial recognition of goodwill, despite possibly having a tax base of zero where the relevant tax jurisdiction does not permit tax deductions for goodwill [§15(a), 21 IAS 12].

Obtaining control by increasing an existing holding ('Step Acquisition')

If control is obtained in stages, the method of accounting will reflect the level of interest acquired at each stage and whether the Equity Method ('EM') or Acquisition Method ('AM') is required. Assuming the first purchase does not trigger the EM (say less than 20% voting rights acquired), the investment would be treated as an Equity Investment under the rules for Financial Instruments, since the investment would meet the definition of Financial Asset [§11 IAS 32]. It would be recognised as a non-current asset at fair value (which may be cost) with changes in fair value being recognised in the P&L (an election can be made for changes in value to be recognised in OCI if the investment is not held for trading) [§4.1.1, 4.1.4, B5.2.3 IFRS 9].

The next acquisition may cross the threshold into EM or even AM. Assuming a move into EM territory, the Equity Investment would be increased by the consideration transferred to obtain the holding that takes it over the line for significant influence (say 20%)(this would include any goodwill). The investment would be re-classified in non-current assets as an 'Associate', with the carrying amount thereafter being adjusted to reflect the investor's share (excluding potential voting rights from options, for example, that would be included when determining significant influence) of the Associate's net assets (share of post-acquisition net income and OCI less dividends received) as well as long-term interests that in substance form part of the investment [§3,10, 12, 38 IAS 28]. The carrying amount would be subject to an impairment charge if there was objective evidence of impairment and testing under IAS 36 as applied to single assets indicated a charge was required to bring the carrying amount down to its recoverable amount [§32,40 IAS 28].

If a further investment means the investor obtains control, the AM will be required with full consolidation [§22 IAS 28]. The investor's interest in the Associate immediately before the investment is re-valued to fair value at the date of the BC (FV_A) and a gain or loss (fair value less carrying amount) is recognised in the P&L, on the basis that the investor is exchanging its interest in an Associate for a Subsidiary [§42 IFRS 3]. Goodwill arising on consolidation will now include this initial fair value of its interest in the Associate, so that: $G = C + NCI + FV_A - NA$. Effectively the investor moves from an investor with significant influence to a parent. The final investment might be where the parent increases control by paying consideration to buy out the NCI. This would be treated within equity as a change in the parent vs. NCI proportion, including any amount paid as consideration in excess of the change in NCI. [§23, B96 IFRS 10].

Derecognition

If a company sells its shareholding with loss of control, under IFRS 10, derecognition of the consolidated assets, liabilities and NCI at their carrying amounts is required [§25, B98 IFRS 10]. The gain or loss is calculated as follows: (all amounts as at the date of loss of control): (1) the fair value of the consideration received + the fair value of any retained interest + the carrying amount of NCI less (2) the consolidated carrying amount of net assets of the subsidiary, including goodwill net of accumulated impairment losses [§B98 IFRS 10].

FINANCING THE CONSIDERATION

REPORTING THE DOMESTIC ACQUISITION FINANCING

Financial Reporting of Debt

A 'Financial Liability' ('FL') includes a 'Financial Instrument' issued under contractual terms that require the delivery of cash or another financial asset when that liability is settled. This would include loans, bonds and convertible bonds, but also preference shares that meet the IAS 32 liability definition. The rights attached to the share, with respect to dividend payments (discretionary or non-discretionary) and redemption (mandatory or an issuer or holder option to redeem), would need to be examined to determine if it exhibits the fundamental characteristics of a FL [§ AG25 IAS 32].

A FL is recognised initially at fair value at the date the entity becomes party to the contract and then at 'Amortised Cost' [§ 3.1.1 IFRS 9], with interest charged to the P&L using the 'Effective Interest Method' and an 'Effective Interest Rate' (see 'Security Valuation: Convertible Bond Pricing' – convertible bonds may contain separate liability and equity components). However, an entity may irrevocably designate a FL as measured at FVTPL if the contract contains an 'embedded derivative' (subject to conditions) or the treatment reduces a recognition or measurement 'Accounting Mismatch', when changes in the fair value of the instrument would be recognised in the P&L (the component of fair value change relating to own-credit risk is, however, normally recognised in OCI) [§ 4.2.1, 4.2.2, 4.3.5, 5.3.1 B4.1.27 IFRS 9].

Financial Reporting of Derivatives

Derivatives in general

Under IAS 32, 'Derivative Financial Instruments (such as...interest rate swaps...) meet the definition of financial instruments' [§ AG15 IAS 32]. Under IFRS 9, a derivative is a financial instrument (1) whose value changes as the price of the 'underlying' variable factor (such as a specific interest rate) changes, (2) which requires nil, or a small, initial investment (swaps are based on a notional principal amount, without any exchange of principal), and (3) which is settled at a future date [App. A IFRS 9].

Derivatives are initially measured at Fair Value (nil for a plain-vanilla swap at inception) and subsequently measured at Fair Value through Profit or Loss ('FVTPL'), unless designated as a Hedging Relationship (see below). Thereafter, an interest rate swap will be recognised as a derivative financial asset or liability, based on the difference in present values of the revised floating rate cash flows (which change as market expectations change): if floating rates increase by more than estimated at inception, when the fixed rate was determined, the PV of the floating rate cash flows should be higher than the PV of the fixed rate cash flows, so the swap would be recognised by the fixed rate payer as an asset (at a fair value equal to the difference), otherwise as a liability (PV pay fixed > PV receive floating). (See p.1121 and p.1678 EY International GAAP 2026 for examples of the initial recognition of a swap and its use to hedge a floating rate loan).

Hedge Accounting for interest rate risk

The borrower (acquirer) will recognise the loan at amortised cost, the swap at fair value. Interest costs will be recognised in the profit and loss account ('P&L'), along with changes in the fair value of the swap. A floating rate loan will expose the borrower to variable interest cash flows, and use of 'Hedge Accounting' will allow the borrower to smooth out financing costs in the P&L if it has hedged the floating rate loan with a pay-fixed/receive-floating swap. The effective portion of such a 'Cash Flow Hedge' [§ B6.5.2 IFRS 9] will be recognised and accumulated in OCI and 'recycled' to P&L to offset against the hedged future interest costs when they are recognised in the P&L; the 'ineffective portion' is charged to P&L. The borrower would need to 'designate a hedging relationship' between part of or the whole swap (hedging instrument) and loan interest rate cash flows (hedged item), and comply with hedge effectiveness requirements and documentation [§6.1.2 - 6.3.3, B6.2.4 IFRS 9].

TAXATION OF DOMESTIC ACQUISITION FINANCING

UK Taxation of Debt Finance

Loan Relationship Rules ('LRR'): General Treatment

A corporate acquirer subject to UK corporation tax will be taxed under the LRR (Part 5, s292-476, CTA 2009) in respect of 'Money Debts' (settled in cash or shares) arising from: (1) actual loans: the lending of money (e.g. cash consideration financed with new borrowings), (2) deemed loans: the issue of an instrument that represents rights of a debt (e.g. loan notes issued as consideration) and (3) a 'Relevant

Non-Lending Relationship' ('RNLR') (including debts subject to interest or exchange differences or debts released or impaired) [s302, s303, s479, s480 CTA 2009].

'Debits' (expenses, losses, capital losses) and 'Credits' (income, profits, chargeable gains) for LRR money debts will be taxed under the LRR, including those of a capital nature and those arising from a 'related transaction' (e.g. sale, exchange, redemption or release) [s292-296, s304 CTA 2009]. The general rule is that the amounts 'brought into account' are those that are recognised in the P&L for the period (including those 'recycled' from Other Comprehensive Income) in accordance with GAAP (UK or IAS) [s307, s308 CTA 2009].

LRR debits and credits are classified as 'trading' if the loan is for the purposes of the borrower's trade (the borrower is party to the LRR 'in the course of activities forming an integral part of the trade' [s298 CTA 2009]). Interest on borrowings relating to an acquisition would normally be treated as 'non-trading'. Debits are offset against credits under each category and any deficit is treated as a trading loss (trading LR deficits) or a Non-Trading LR Deficit ('NLTLD') [s301 CTA 2009].

For deficits arising after 1 April 2017 ('streamed' losses and deficits arising before this date are treated differently and not discussed here), relief is given against total taxable profits in the current year, the previous 12 months or future years, except NTLRD can only be carried back 12 months against non-trading LR profits (or derivative credits). Both deficits can be surrendered to other group companies under 'Group Relief' provisions, however all deficits will be subject to carry forward restrictions that limit relief in any year to a 'Deductions Allowance' (£5m) plus 50% of 'Relevant Profits', being 'Qualifying Profits' in excess of £5m (per group). The CIR rules affect current period taxable profits, so brought forward losses are applied to the CIR restricted profits [s37, s45A CTA 2010; s463A,s463B,s463G CTA 2009] [see HMRC CFM32070].

Exceptions to the General Treatment Rules

Introduction

The general rule is subject to a number of exceptions:

- Interest treated as a distribution: 'credits or debits relating to any amount falling, when paid, to be treated as a distribution must not be brought into account for the purposes of this Part, except, in the case of credits, so far as they are avoidance arrangement amounts' [s465 CTA 2009] [HMRC CFM30150].
- 'Disguised Interest': where a company is party to an arrangement which produces a return economically equivalent to interest, that amount is brought into the LRR, based on the amortised cost method [s486B CTA 2009] [HMRC CFM42040]
- Deferred deduction for certain interest paid late: deduction for interest payable by a 'Close Company' borrower to a 'Participator' lender is deferred until payment if the interest is not paid within 12 months after the end of the accounting period in which it is accrued, provided that the

lender does not bring the full amount of the corresponding interest into account for the purposes of the LRR (a close company is, broadly, a company controlled directly or indirectly by either five or fewer 'Participators' – including a shareholder or loan creditor – or any number of directors who are Participators) [s373, s375 CTA 2009; s439, s454 CTA 2010] [HMRC CFM35810].

- Restrictions imposed by the Corporate Interest Restriction (CIR) [s372-s498 TIOPA 2010].
- Amounts in respect of loans deemed to be for an Unallowable Purpose [s442 CTA 2009].
- LRR involving connected parties (e.g. intra-group loans): debits and credits are determined using the amortised cost method if the fair value method is used in the financial statements [s349 CTA 2009] [HMRC CFM35030].
- Anti-Avoidance rules that counteract 'relevant avoidance arrangements' [s455B-s455D CTA 2009] [HMRC CFM39560].
- LRR not at arm's length where arm's length adjustments are made, other than those dealt with under the 'Transfer Pricing' rules² [s444, s445 CTA 2009] [HMRC CFM38405], and 'mismatches' [Part 21BA CTA 2010 and Part 6A TIOPA 2010] [HMRC CFM77500].

Disguised Distributions

'Interest' is not defined in the legislation for tax purposes, but an amount would be considered as 'an interest of money' if it arose from a legal right to payment for the return or compensation for use of a principal sum over time or 'payment by time for the use of money' [Bennett v Ogston (1930) 15 TC 374 - see HMRC CFM33030].

A distribution, by contrast, is defined and would include the following:

- A distribution 'out of assets of the company in respect of shares in the company' in excess of amounts treated as a repayment of share capital or amounts received as consideration for the distribution (cash or non-cash) [s1000B CTA 2010].
- A 'transfer of assets or liabilities by a company to its members, or to a company by its members' where value received by the shareholder exceeds value given by shareholder (distribution at undervalue) (excluding repayment of share capital) [s1000G, s1020 CTA 2010]
- Excessive interest (more than a 'reasonable commercial return') on 'non-commercial securities' [s1000E, s1005-1007 CTA 2010]

² A parental loan to the acquirer to fund the cash component would normally require consideration of 'Transfer Pricing' rules that effectively adjust transactions to arm's length arrangements, but for accounting periods beginning on or after 1 January 2026, a UK-to-UK exemption may apply where the statutory conditions are met and no disqualifying criterion applies (but it will not apply to a cross-border loan from an overseas parent).

- Interest on 'Special Securities', including (i) unlisted convertible securities issued on terms which are not reasonable compared to comparable listed convertibles and (ii) interest payable that depends on the borrower's business performance [s1000F, s1015 CTA 2010].

The formal waiver or release of a loan by the lender would be taxed under the LRR as giving rise to debits and credits. However, the effect will be tax neutral if the lender and borrower companies are 'connected' (wherever tax resident), unless the 'deemed release' rules apply (broadly, where a connected company has acquired the debt at a discount, or the lender and borrower became connected while the debt was impaired, when a taxable credit will arise for the borrower). If a subsidiary waives a loan to its parent, the LRR are 'switched off' but the waiver would still be treated as a distribution, although not subject to tax as distributions to and by companies are not charged or relieved. An intra-group debt release may be required if a parent is disposing of a subsidiary to the acquirer, in which case it would generally be tax neutral, for these reasons [s322, s354, s358, s361, s362, s472 CTA 2009] [see HMRC CFM41060, CFM41070].

Corporate Interest Restriction ('CIR')

The CIR rules were introduced in Finance (No.2) Act 2017 in response to the OECD's 'Action 4: 2015 Final Report', issued under its Base Erosion and Profit Shifting ('BEPS') Project, that recommended a cap on tax deductions for interest and interest-equivalent costs. Under Part 10 TIOPA 2010 (s372-s498) (all references below are to TIOPA 2010, unless stated otherwise), the maximum amount of the *UK* 'Aggregate Net Tax Interest Expense' ('**ANTIE**') that is deductible for tax purposes ('**Interest Capacity**') is the greater of:

- the '**Interest Allowance**' ('**IA**') for the period (plus unused IA brought forward from the previous 5 years), and
- the £2m de minimis amount (for the group, not per company, assuming a 12 month period) [s389, s390, s392]

The IA is calculated as the Basic Interest Allowance ('**BIA**') plus Aggregate Net Tax Interest Income, where the BIA is:

- if no group ratio election applies (i.e. the default provision), the Fixed Ratio Interest Allowance ('**FRIA**'), calculated as the lower of:

- (1) $30\% \times \text{UK 'Aggregate Tax-EBITDA'}$ and
- (2) the Fixed Ratio Debt Cap³, equal to the *Worldwide Group* 'Adjusted Net Group Interest Expense' ('**ANGIE**'), which is equal to the Net Group Interest Expense ('**NGIE**') +/- adjustments ['A1']. [s372, s397, s405, s496]

³ Amounts in respect of prior periods (Excess Debt Cap brought forward) have been ignored to simplify matters, as are the rules for Qualifying Infrastructure Companies ('QICs').

- if a group ratio election is made (to maximise the BIA using the 'Group Ratio Method'), the Group Ratio Interest Allowance ('**GRIA**'), calculated as the lower of:
 - (1) the 'Group Ratio Percentage' ('**GRP**') x UK 'Aggregate Tax-EBITDA' and
 - (2) the *Worldwide Group* 'Qualifying Net Group Interest Expense' ('**QNGIE**', the GRIA 'Debt Cap'³), equal to ANGIE - adjustments ['A2'], so QNGIE = NGIE +/- A1 - A2. GRP is defined as QNGIE as a percentage of Worldwide '**Group EBITDA**' (max 100% or 100% if negative). [s396, s398-399, s416]

The figures derive from UK corporation tax returns (ANTIE, tax-EBITDA) and consolidated financial statements for the Worldwide Group prepared under International Accounting Standards (IAS) (NGIE, ANGIE, QNGIE, Group EBITDA) [s373, s479, s488, s492].

The Total Disallowed Amount of interest (= ANTIE – IC) [s373] is allocated between UK group members and can be carried forward indefinitely for deduction in future periods if claimed as 'Reactivated Interest' (subject to further restrictions). If there is no restriction, unused IA (= IA – ANTIE) can be carried forward for up to 5 years [s393-395]. See [Appendix 3](#) for an example.

Loan for an Unallowable Purpose

If a LR has an Unallowable Purpose ('UP'), interest payable on the loan, or any portion that is attributable to the UP on a just and reasonable basis, will not be allowed as a tax deduction. A UP will arise in an accounting period if, 'at times during that period', the purposes of the loan include a purpose (the UP) which is not amongst the business or other commercial purposes of the company. If one of the purposes of the loan is to secure a 'tax advantage' for the company or any other person ('tax avoidance purpose'), it will not be amongst the business or other commercial purposes unless it is not the main purpose or one of the main purposes for the loan [s442 CTA 2009]. With regard to interest payable on a loan, a tax advantage would include 'a relief from tax or increased relief from tax' [s1139 CTA 2010]. HMRC provide guidance on assessing whether securing a tax advantage is the main purpose [HMRC CFM38170].

A main purpose may be a commercial purpose that obtains a non-tax related commercial benefit, but if a tax avoidance purpose is one of the other main purposes, an UP will exist: 'The company will have a "tax avoidance purpose" if it is seeking to play its part in a scheme which, to the knowledge of the relevant decision-makers, was designed to secure a tax advantage. The fact that the decision-makers consider that entering into the loan relationship is in the company's interests for other reasons does not preclude them from having a "tax advantage purpose"' [JTI Acquisition Company (2011) Ltd v HMRC [2024] EWCA Civ 652, Lord Justice Newey at 51].

Financing the acquisition of a third-party company by a group subsidiary in a manner that obtains a tax advantage for the group, may well be caught, as illustrated in the JTIAC case, where, although the acquisition was commercially driven, the LRR existed only for a tax avoidance purpose. In that case, a newly incorporated UK subsidiary (JTIAC) of a US parent ('JTI', a subsidiary of the ultimate US parent,

Joy Global Inc., 'JGI') acquired a US company for \$1.1bn, \$550m of which was funded by JGI via a loan from JTI. As JTIAC was not trading, the interest on the loan would have been treated as non-trading LR debits that could be transferred to other UK group subsidiaries via group relief and so obtain 'a relief from tax'. The decision-makers included directors higher up the group: 'The directing minds in the present case on whom the purpose test is to be applied' [at 173] '....would not be confined to those three directors ... appointed to the board of the Appellant [JTIAC], but would extend to include the directing minds of JGI as the ultimate parent' [at 148] '...and their object in implementing the Deloitte scheme was to bring into existence the loan relationship of which the Appellant would be a party, thereby securing a UK tax advantage by generating the free-standing loan relationship debits for the UK members of the JGI group' [at 153].... The post-completion evidence ... points overwhelmingly to the fact that to obtain the UK tax advantage was the sole purpose for the Appellant being party to the loan relationship' [at 170] [First Tier Tribunal 2022: Judge Heidi Poon]. The Court of Appeal agreed. By contrast, in *BlackRock HoldCo 5 LLC v HMRC* [2024] EWCA Civ 330, unlike JTI (sole tax-avoidance purpose), BlackRock had both a commercial main purpose and a tax-avoidance main purpose, and the Court of Appeal still disallowed the interest under the unallowable-purpose rule.

UK Taxation of Derivatives

The profits and losses arising from the change in fair value of the interest rate swap will be taxed in the UK under Part 7 CTA 2009 (s570-710). The swap, as for any derivative, would need to meet the accounting definition (IFRS 9), be a 'relevant contract' (a swap falls under the s582 'contract for differences' relevant contract) and not be excluded [s576 CTA 2009]. As for loan relationships, derivatives debits (losses) and credits (gains) will be treated as trading or non-trading and taxed in the period in which they are recognised in the P&L or re-cycled from OCI to the P&L [s573, s574, s595, s597 CTA 2009]. If a borrower does not use Hedge Accounting for a loan hedged with an interest rate swap, changes in the carrying amount of the swap (fair value) may differ from changes in the carrying amount of the loan (amortised cost), leading to tax volatility that bears little relationship to the economics of the hedge. The 'Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations' were introduced in 2004 (and amended in 2015), effectively to make adjustments to ensure treatment is similar whether or not Hedge Accounting is applied.

Cross-border Business Combinations

Consolidation Approach

Part 1 discusses how an acquirer would recognise the target in its consolidated financial statements under International Accounting Standards (IFRS 3, IFRS 10). This Part extends the discussion to include consolidation of a foreign subsidiary acquired in a business combination. IAS 21 deals with:

- translation of the results and financial position of foreign 'operations', such as subsidiaries and associates accounted for under the acquisition and equity methods discussed above (IFRS 3, IAS 28);
- treatment of foreign currency denominated transactions, such as sales, expenses and capital expenditure invoiced in a foreign currency or foreign currency denominated financial instruments, which would be recognised according to each relevant Standard, subject to IAS 21's requirements.

An entity (a parent, foreign subsidiary or any standalone entity) must first determine its 'Functional' currency - defined under IAS 21 as the currency of the primary economic environment in which it operates (normally the one in which it 'primarily generates and expends cash') – whether or not it prepares separate financial statements. The functional currency may be obvious (IAS 21 provides indicators which are discussed below), but, if not, management must use judgement to assess which currency faithfully represents the economic effects of the 'underlying transactions, events and conditions' [§ 8, 9,12,13, 17 IAS 21]. Once determined, the functional currency can only be changed if there is a change in these transactions, events and conditions [§ 13,35,36,37 IAS 21].

The currency of transactions which are not the entity's functional currency is a 'foreign currency' [§8 IAS 21]. The entity must follow the requirements of IAS 21 to translate foreign currency transactions into its functional currency (a common currency). This will give rise to exchange gains or losses if spot exchange rates change over the transaction / settlement / reporting dates period, depending on the recognition requirements. The functional currency may be different to the 'Presentation' or reporting currency, which the entity is free to choose (unlike the functional currency, which is a matter of fact – discussed below). Translation from the functional to presentation currency will give rise to additional exchange gains or losses. [paras. 8,17,18,38 IAS 21]

The procedure for translating from transaction to reporting date involves several steps:

- Step 1** Foreign currency denominated transactions are initially recognised by translating the foreign currency amount ('FC') to the functional currency ('fC') using the spot exchange rate at the transaction date ('TD')(the date the transaction first qualifies for recognition) ('Spot_{FC/fC TD}') (an average rate is permitted in certain cases) [§21, 22 IAS 21].
- Step 2** The settlement of monetary items (such as receivables, payables or borrowings) will lead to exchange differences if the spot rate at the settlement date (SD) differs from the spot rate when previously translated: the transaction date if in the same period ($\text{Spot}_{FC/fC SD} \neq \text{Spot}_{FC/fC TD}$), the prior balance sheet date (BD_{t-1}) if not ($\text{Spot}_{FC/fC SD} \neq \text{Spot}_{FC/fC BD_{t-1}}$). This exchange difference is recognised in the P&L in the entity's own financial statements (there is an exception in consolidated accounts, discussed below) [paras. 28,29,32 IAS 21].
- Step 3** Monetary items that have not been settled by the balance sheet date are translated at the spot rate at that date ('Closing' rate), with any exchange difference ($\text{Spot}_{FC/fC BD_t} \neq \text{Spot}_{FC/fC TD}$) being recognised in the P&L (if the initial transaction occurred in the prior period, the gain or loss would represent spot rate change over the reporting period). [paras. 23,28 IAS 21].
- Step 4** Non-monetary items (such as tangible fixed assets) are recognised at their initial 'historic' rate ($\text{Spot}_{FC/fC}$) and are not retranslated unless they are revalued or carried at fair value, when the exchange rate at the valuation date is used. Exchange differences relating to valuation changes are recognised in the same component of total comprehensive income as the valuation gain or loss (e.g. those arising on the revaluation of property, plant or equipment under IAS 16, which are recognised in Other Comprehensive Income) [paras. 23, 30 IAS 21]
- Step 5** If the subsidiary's functional currency is different to the group presentation currency ('PC') – which may or may not be the parent's functional currency - financial 'elements' (balances and flows) must be retranslated from the entity's functional to presentation currency:
- assets and liabilities are retranslated using balance sheet exchange rates ($\text{Spot}_{fC/PC BD}$),
 - P&L items are translated using transaction date rates (or an average rate if rates do not fluctuate significantly) ($\text{Spot}_{fC/PC TD}$).

Exchange differences are recognised in Other Comprehensive Income and not the P&L (the choice of presentation currency has no effect on cash flows), and will represent changes in spot rates between successive balance sheet dates (and on first translation from the transaction date). [paras. 39,40,41 IAS 21]. This gives the subsidiary's results and financial position denominated in the group presentation currency.

- Step 6** As mentioned in step 2, a consolidation adjustment needs first to be made for all exchange differences arising on a monetary item forming part of the 'Net Investment' in a foreign operation, since these are initially recognised in Other Comprehensive Income in consolidated accounts and reclassified to the P&L on disposal of the foreign operation (compared to directly in the P&L in separate accounts) [§ 32 IAS 21].

Step 7 Consolidation can now take place from the date of acquisition using the approach described above, with the following additional factors to consider:

- The fair value of consideration transferred and the fair value of the foreign target's assets and liabilities are expressed in the target's functional currency at the date of acquisition when determining goodwill. Fair value adjustments and goodwill are therefore treated as arising in the foreign entity and are translated at the closing rate into the parent's presentation currency, as for other assets or liabilities [§47 IAS 21]
- Deferred consideration in the form of a cash earn-out will be recognised as a financial liability and translated, as for any monetary item, at the balance sheet date closing rate, although the exchange gain or loss will be recognised as part of the change in fair value of the contingent liability.

Determining the Functional Currency

Every entity should determine its functional currency using the following indicators, giving priority to primary indicators:

- [1] currency (i) that mainly influences output prices (sales) and input prices (labour, material and other costs) relating to the goods and services provided; and (ii) of the country whose competitive forces and regulations mainly determine the sales prices (primary indicators) [§9 IAS 21]
- [2] currency in which funds from financing activities are generated and the currency in which operating cash flow receipts are usually retained (secondary indicators) [§ 10 IAS 21]

If it is not obvious which is the entity's functional currency, management uses its judgement when making the determination, for the purposes of the entity's separate financial statements, by considering the indicators in §9 first and only then those in §10 ('additional supporting evidence').

In the case of an entity that is a foreign subsidiary (or associate), IAS 21 provides additional indicators [§11] that are considered along with those in § 10 once indicators in §9 have not provided the answer. These indicators are:

- [1] The degree to which the foreign operation (i) carries out its activities as an extension of the parent rather than with a significant degree of autonomy, or (ii) has a low or high proportion of its activities in the form of transactions with the parent.
- [2] Whether the foreign operation's cash flows (i) are readily available for remittance to the parent and directly affect the parent's cash flows and (ii) are adequate to service its debt obligations (existing and normally expected debt) without parental funding

If the operation is 'integral' to the parent (direct extension, high interconnection, shared cash flows, dependent financing) it will have the same functional currency as the parent [BC6 IAS 21]. This will probably be the case for an intermediate holding company set up by the parent (acquirer) for the purpose of an acquisition, since it will most likely be acting as an extension of the parent: it will not have any

activities other than passively holding an investment on behalf of the parent, receiving dividends from the target and servicing debt it has obtained for the acquisition (which the parent will probably have to guarantee).

TAX ISSUES FOR THE OVERSEAS ACQUISITION

Tax Evaluation Framework

A number of tax questions need to be considered by a UK acquirer expanding overseas, which include the following (these are discussed in more detail below):

- Will local operating presence be in the form of a branch (the same legal entity as the parent, so a trade would be commencing) or subsidiary (a company incorporated with the parent as subscriber, either trading itself or used to acquire an existing business via an asset or share purchase)? This article is concerned with the acquisition of an existing business, located in a territory chosen for strategic non-tax reasons, via a share purchase.
- Will the acquisition bring the group into the OECD Pillar 2 €750m revenue threshold? If the acquirer-target group consolidated revenue in at least two of the four previous accounting periods is €750m or more (s129 Finance (No.2) Act 2023), the group will fall within the OECD Pillar 2 (GloBE) rules which impose a minimum 15% effective tax rate in each jurisdiction.
- Should the UK company acquire the overseas target company directly or via an overseas intermediate holding company ('IHC') (if so, which country)? If more overseas acquisitions will be made, how can the acquisition structure be flexible enough to accommodate these? The answer will depend on answers to many of the following questions.
- Where will the chosen entity be resident for tax purposes, and how do the UK and overseas territory determine residence? Will the group's activities create a Permanent Establishment in an overseas territory (such as a branch of the UK acquirer, any IHC or the target itself)?
- How can double tax be prevented? Is there an adequate Double Taxation Treaty in place?
- How will the operating entity's profits be taxed and losses relieved? What anti-avoidance rules apply to intra-group transactions, requiring an adjustment to the target's profits?
- Will a change of control have any tax consequences for the target entity (e.g. availability of losses or interest capacity carried forward before the date of acquisition)?
- What historic tax liabilities does the target have and how will the acquirer be protected against them in the sale and purchase agreement?
- How will the acquisition be financed, both the purchase cost and the target's post-acquisition funding requirements? If cash financed (rather than a share exchange), where an IHC is used, which entity will borrow externally? How will intra-group funding be treated?
- What taxes will arise on the acquisition transaction? What taxes arise on the share transfer? How will the costs associated with the acquisition (e.g. legal and professional fees) be tax relieved? How will costs associated with funding the acquisition cost be relieved?

- Will the UK parent be taxed on any profit generated in the overseas subsidiary under the Controlled Foreign Company rules?
- How will post-acquisition cash flows (dividends, interest, royalties) from the target up to the UK parent (possibly via an IHC, where inbound and outbound flows may be taxed) be taxed? How will withholding tax be relieved in each recipient entity? (1) via double tax treaty and the target's local rules: target → UK, target → IHC_{Non-EU}, target_{Non-EU} → IHC_{EU}, (2) via EU directives: target_{EU} → IHC_{EU}. Are any remittance restrictions in place that might 'trap' cash in the entity? What local anti-abuse rules test this relief (e.g. the Principal Purpose Test, Anti-Conduit, Beneficial Ownership)?
- What tax arises when the subsidiary is sold? If an intermediate holding company is used, at which level in the structure will the disposal be made? Is there a UK equivalent Substantial Shareholding Exemption?

Tax Residence

A local taxable presence will depend on how it is defined under local rules. If a tax jurisdiction follows the OECD Model Tax Convention on Income and Capital (2017) ('OECD Model'), a branch of a UK parent situated in that jurisdiction, although not a legally separate entity, will usually constitute a 'Permanent Establishment' ('PE') (a fixed place of business – Article 5 of the OECD Model and s1141 CTA 2010 in the UK) and be subject to local tax on profits attributable to it; in other cases, a tax liability for an unincorporated entity may arise for other reasons.

A company may be tax resident in a country under various rules: (1) it is incorporated there (a statutory test, such as s14 CTA 2009 in the UK); or (2) if not incorporated there (i) its place of 'central management and control' ('CMC') is exercised there (a common law test, as in the UK, Canada, Australia and Ireland) or (ii) its 'Place Of Effective Management' ('POEM') is there (as in France, Germany, Italy and the Netherlands). Several jurisdictions apply more than one test – the UK, Canada, Australia and Ireland treat incorporation as the primary test and CMC as a secondary, common law test for companies not incorporated there.

CMC is concerned with where real control of the company's business is actually exercised - where its real business is carried on and where its true place of management lies - following *De Beers Consolidated Mines v Howe* [1906] AC 455 (illustrated in *Development Securities plc v HMRC* [2020] EWCA Civ 1705). The OECD's version is POEM, which considers where senior decision makers make key management and commercial decisions necessary for the conduct of the business as a whole [see HMRC INTM120085].

If a company is incorporated in a jurisdiction where incorporation determines tax residency, it may also be resident in another country ('Dual Resident') where CMC or POEM is a deciding factor. For example, a foreign-incorporated company may be treated as UK resident if CMC is in the UK; conversely, a UK-incorporated company may be resident in another country where its CMC or POEM is located, when it becomes 'Treaty Non-Resident' if the applicable treaty produces that result (s18 CTA 2009 treats it as non-UK resident, overriding the s14 incorporation rule – see HMRC INTM120070).

Where a Double Tax Treaty exists between the two countries, a 'Tie Breaker' clause may determine tax residence – for example, the UK-German treaty awards residence to the POEM ⁴. Alternatively, where the treaty has been modified by the OECD's Multilateral Instrument ('MLI'), as with the UK-Ireland treaty, the tie-breaker instead requires the competent authorities of both countries (HMRC in the UK) to try to reach agreement, with treaty benefits potentially withheld if they cannot ⁵.

Tax arising on Target – Acquirer cash flows

The most likely remittances to the parent (either direct or via an intermediate holding company (IHC)) will be (1) royalties (if intellectual property owned by the acquirer is licensed to the target), fees for head office services and interest on parental loans, for which target will want a tax deduction in its taxable profits computation, and (2) dividends for parental equity funding (distributed from profits that have already been taxed).

The tax jurisdictions of the acquirer company (UK) and target company (EU or non-EU) will most likely assert taxing rights based on (1) profits arising within its territory ('source-based jurisdiction') (the target company's own profits) and (2) profits arising worldwide ('residence-based jurisdiction'), such as beneficial entitlement to (whether remitted or not): (a) foreign branch profits, and income from and gains on foreign assets, and (b) foreign royalties, interest and dividends.

The worldwide profits may be taxed in both jurisdictions, leading to a double taxation charge: "International juridical double taxation can be generally defined as the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods" [para.1. Introduction - OECD Model]. A double tax treaty ('DTT') between both countries should relieve this tax.

The acquirer's foreign-source income described 2(b) is the main focus here, since it leads into a discussion about the use of intermediate holding companies (IHC). Foreign-source royalties, interest and dividends may be subject to 'withholding tax' ('WHT'), which may be reduced or eliminated under domestic law and DTT, subject to the relevant conditions and claims procedures. Where the income is taxable in the UK, credit relief may be available under a DTT or the unilateral relief provisions [s18 TIOPA 2010], even if no DTT exists. Credit relief is restricted to the foreign tax suffered and cannot exceed the UK tax attributable to the same source. WHT in excess of the applicable DTT rate should be reclaimed from the overseas country.

⁴ "Article 4: resident....3) Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated." [2010 UK-Germany Double Taxation Convention as amended by the 2021 Protocol].

⁵ "Article 4: fiscal domicile....3) Where by reason of the provisions of the Convention a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors." [Synthesised text of the Multilateral Instrument and the 1976 UK-Ireland Double Taxation Convention]

A dividend received by a UK parent from an overseas subsidiary would normally be exempt under Part 9A CTA 2009. For a UK parent that is not a 'small company', exemption is given for dividends from controlled companies and in respect of non-redeemable ordinary shares [s931E, s931F] – both sections are subject to anti-avoidance arrangements. Exempt dividends will not suffer tax against which to credit WHT, so any WHT in the source country which cannot be relieved represents a tax cost.

For taxable income:

- Royalties and interest: UK corporation tax would be charged on the gross income (amount received + WHT) and reduced by WHT relief to the extent that the combined UK tax and WHT equals the higher of the UK tax rate (25%, assuming the main rate applies) and the WHT rate.
- Non-exempt dividends: relief may be available for underlying Tax ('UT') attributable to the profits out of which the dividend is paid - where the recipient controls, directly or indirectly, at least 10% of the voting power [s12, s14 TIOPA 2010] – and WHT. The gross dividend (dividend received + UT + WHT) is taxed at the UK rate and UT and WHT deducted to arrive at the net UK tax payable (nil if a negative result).

EU directives can provide exemption from WHT for qualifying companies in different EU Member States (other conditions apply):

- Parent-Subsidiary Directive 2011/96/EU: dividends paid by a subsidiary to a qualifying parent holding at least 10% of its capital (or voting rights).
- Interest and Royalties Directive 2003/49/EC: broadly, interest and royalties paid by an 'associated' company to a company holding at least 25% of its capital (or voting rights).

Since the UK is no longer an EU member, relief will not be available under these Directives, only under the overseas country's domestic law, a DTT or unilateral relief. The EU directives may apply to payments from the target to an IHC, if both are resident in Member States and all the relevant conditions are met.

Acquisition Structure

Choosing the location of the company that acquires the target shares, whether in the UK (direct acquisition) or overseas (indirect acquisition using an IHC), will require evaluation of a number of factors, including the following:

- Taxation arising in the IHC
- Dual residence issues if the acquirer or IHC actively manage the target operations
- Taxation of income from the target to the UK directly or via an IHC (an EU or non-EU member)
- Acquisition and post-acquisition funding and tax relief on interest (including restrictions such as the Corporate Interest Restriction rules ('CIR')).
- Anti-avoidance and other rules that might affect the desired outcome (Transfer Pricing, Hybrid Mismatch, Controlled Foreign Companies – discussed below – and other local anti-abuse rules).
- Capital gains exemptions available on a sale of the target or the IHC holding the target

REPORTING THE OVERSEAS ACQUISITION FINANCING

Financial Reporting of Foreign Currency Debt

A foreign currency loan will be a financial liability initially measured at fair value (less directly attributable transaction costs, if the loan is not measured at fair value through profit or loss) and subsequently at amortised cost using the effective interest method in IFRS 9 (see 'Security Valuation – Convertible Bond Pricing'). The loan will be a monetary item retranslated at each balance sheet date, as discussed above. Amortised cost is determined in the foreign currency and translated at the closing rate.

An intra-group foreign currency loan from the UK parent to its subsidiary will be eliminated on consolidation (along with interest), except for any exchange difference (assuming both companies have different functional currencies). An exchange gain or loss arising on the monetary item will be recognised in the profit and loss account of the parent's separate and consolidated financial statements, however if treated as a 'Net Investment' the gain or loss will not be recognised in the consolidated profit and loss but in Other Comprehensive Income (reclassified from equity to the profit and loss on disposal of the subsidiary) [paras.28, 32, 45 IAS 21]. The loan would be treated as a Net Investment if settlement is neither planned nor likely to occur in the foreseeable future and the loan essentially represents the parent's interests in the subsidiary's net assets [§ 15, App. A IAS 21].

Hedge Accounting for Currency Risk

Managing foreign exchange risk with derivatives (or the foreign currency risk component of a non-derivative financial instrument [§6.2.2. IFRS 9]) may permit the use of hedge accounting, providing the requirements for hedge accounting are met. An eligible reliably measured hedged item and hedging instrument will need to be identified:

- The legal commitment to pay foreign currency consideration will create an exchange rate exposure from the date of commitment to date of payment:
 - An 'unrecognised firm commitment' can be an eligible hedged item, but a firm commitment to acquire a business in a business combination will only be eligible in respect of foreign currency risk [§ 6.3.1, 6.3.2, 6.3.3, B6.3.1, App.A IFRS 9].
 - The hedging instrument could be a forward exchange contract or currency option. A 'deal contingent' forward would only have effect if the acquisition completed, so that, unlike a traditional forward where there is an obligation to deliver, the forward would be terminated without penalty.
 - A hedge of the foreign currency risk of a firm commitment can be accounted for as a *fair value* or *cash flow hedge* [para 6.5.4 IFRS 9]. A fair value hedge is a hedge of the exposure to changes in the fair value of a recognised asset or liability, or of an unrecognised firm commitment (in

whole or part), that is attributable to a particular risk (such as currency risk) and could affect profit or loss [§6.5.2, B6.5.1, App.A IFRS 9].

- The hedging instrument is recognised at the date the derivative contract is entered into (date of agreement) and any change in fair value recognised in profit and loss. The firm commitment (purchase price) stays unrecognised until completion, however the cumulative change in its fair value due to exchange rate movements since it was designated as the hedged item is recognised as an asset or liability, with a corresponding gain or loss in profit or loss. This offsets the fair value changes on the hedging instrument. Any ineffectiveness stays in profit or loss [§6.5.8(a)(b), 6.5.9 IFRS 9].
- The contractual foreign currency denominated loan cash flows will expose the borrower to currency risk (and interest rate risk, depending on whether the loan has a fixed or floating rate):
 - Foreign currency loan payments would be eligible hedged items under a cash flow hedge (cash flow variability attributable to currency risk that could affect profit or loss) [para 6.5.2 IFRS 9].
 - The hedging instrument would most likely be a cross currency swap entered into on completion, when the foreign loan is drawn down and used to pay the cash consideration.
 - The cumulative change in fair value of the swap that is determined to be an effective hedge (capped at the cumulative change in the present value of the loan's expected cash flows) is recognised in Other Comprehensive Income / 'OCI' as a 'Cash Flow Hedge Reserve' and reclassified to profit and loss when the underlying exposure relating to interest and principal is recognised in the profit and loss. Amounts relating to hedge ineffectiveness are recognised in the profit and loss [§6.5.11 IFRS 9].
 - A cash flow hedge is intended to defer the gain or loss on the hedging instrument to match the period when the cash flows affect profit or loss [§ B6.5.2 IFRS 9].
- The consolidation of the foreign target will create 'translation' exposure if the foreign subsidiary functional currency is different to the parent's presentation currency (differences are recognised in OCI as discussed above).
 - A hedge of the foreign currency exposure in a Net Investment in a foreign operation (as defined above under IAS 21 and IFRIC 16) is eligible for hedge accounting only in respect of foreign exchange differences between the functional currency of the subsidiary and parent (and not the latter's presentation currency)[§10 IFRIC 16].
 - The hedging instrument can be a derivative (such as a foreign exchange forward) or non-derivative financial instrument (such as borrowings – this hedge would be an alternative to the hedge using a swap above.
 - The gain or loss on the hedging instrument attributable to an effective hedge is recognised in a Foreign Currency Translation Reserve in OCI (the ineffective portion recognised in profit or loss) – reclassified to the profit and loss account on disposal of the subsidiary - and included in the consolidation translation differences. [§6.5.13 IFRS 9, § 16,17 IFRIC 16]

TAXATION OF OVERSEAS ACQUISITION FINANCING

Assuming a cash transaction ultimately financed with third party debt (a bank, for example), the funding possibilities could include the following:

- 1 The acquirer borrows and:
 - (a) purchases the target shares directly⁶ or
 - Bank interest would be subject to CIR and Unallowable Purpose³
 - Target dividends would be exempt and not available to absorb the bank interest costs.
 - Target remittances must cover bank debt servicing costs when due, after tax leakage and local cash needs.
 - (b) passes the funds to the IHC via a:
 - (i) shareholder loan and/or
 - Shareholder loan interest receipts, after WHT and other applicable taxes, together with existing funds, should be sufficient to meet external bank interest and principal repayments
 - Intra-group financing transactions will be subject to Transfer Pricing and Hybrid mismatch rules
 - Assess available domestic and DTT relief from WHT
 - HC obtains tax relief on shareholder loan interest (subject to local equivalent CIR rules), which could be sheltered against target profits (group relief equivalent)
 - (ii) subscription for share capital
 - Target dividends would be exempt and not available to absorb the interest costs
 - IHC obtains no tax relief on dividends, so income is not sheltered
 - Less flexible when withdrawing capital than a loan
- 2 The IHC borrows
 - Debt servicing would need funding from target dividend
 - Debt is 'pushed down' so interest costs are as close as possible to the source of trading profits used to absorb them via a group relief equivalent, which would probably require the IHC and target to be in the same tax jurisdiction (the target dividend would be exempt, so the IHC is unlikely to have income itself to absorb the costs). This is the same as the preceding point but moved down a level.

⁶ Alternative methods to achieve a 100% shareholding (or the whole business and assets of the target) are not considered here, but might include a statutory merger or a subscription combined with a share buyback of existing target shareholders (this may avoid tax on share transfers, but would have disadvantages – the buyback might be treated as an income distribution for the target shareholders, target company law may restrict the repurchase to maintain capital and the whole transaction may be caught by anti-avoidance rules).

- Bank lenders will need credit support via parental guarantees and security over target's assets or shares
- The parental guarantee is a transfer pricing risk.
- Local rules may treat the IHC as lacking substance and a conduit, denying DTT benefits
- CIR equivalent rules will limit interest costs

There will be non-tax factors that need to be considered when structuring, such as: exit route (the best locations for a trade buyer, private equity investor or IPO), security laws affecting the IHC bank borrowing route, target management incentive plans, regulatory issues, etc.

Tax on Foreign Currency Financing and Hedging

A UK resident company's taxable profits must be expressed in sterling [s5 CTA 2010]. If its presentation and functional currency are both sterling and it transacts in a foreign currency (e.g. pays interest on a foreign currency loan or receives taxable income in foreign currency from an overseas subsidiary), the taxable amount will be the amount recognised in the financial statements (under IAS 21 if International Accounting Standards are used). If its functional currency is not sterling (but its presentation currency is), the foreign currency transactions are taxed as if the company prepared its accounts in the functional currency and converted those amounts into the 'sterling equivalent' at the average exchange rate for the period, the spot rate for a single transaction or a rate based on spot rates for multiple transactions, "derived on a just and reasonable basis" (s7, s11 CTA 2010).

If a UK acquirer (assumed here to be a trading and not pure investment company), with a functional currency in sterling, uses the proceeds from a foreign currency loan to purchase the foreign target shares directly or subscribe for shares in an intermediate holding company ('IHC'), it will have a foreign currency monetary item (liability) that is translated at the balance sheet closing rate in its own accounts under IAS 21, with any exchange gains or losses (realised and unrealised) being brought into account for tax purposes under s328 CTA 2009 (part of the Loan Relationship Rules). The shares acquired or subscribed for will be a non-monetary item that, if recognised at cost in the separate financial statements, will be translated at the historic exchange rate. In the absence of special rules, no exchange gain or loss will arise that could offset the opposite loss or gain on the borrowings. The Disregard Regulations S.I. 2004 No. 3256 ⁷ (as amended) and s328(4) CTA 2009 require the loan exchange gain or loss to be ignored if conditions are met. If the UK acquirer lends the funds to the IHC, these regulations will not apply because the asset would not be eligible. The loan to the IHC will be a monetary item (a receivable), with exchange gains or losses recognised (offsetting those on the borrowing), so the regulations are not needed.

Anti-Avoidance Profit Adjustments & Apportionment

Transfer Pricing

If a UK parent lends an overseas subsidiary funds to acquire the overseas target, 'Transfer Pricing' ('TP') rules will need to be considered in the overseas jurisdiction. These anti-avoidance measures are

triggered when any cross-border intra-group transaction is based on non-arm's length (non-market) terms, such as an above market interest rate (irrespective of any tax motive to exploit tax rate differences that effectively shift profits to low tax jurisdictions). Examples include:

- Exporting goods and services - at above arm's length prices - from a subsidiary in a low tax jurisdiction to a subsidiary in a high tax jurisdiction: although the amount of tax payable by the exporter would be greater compared to an arm's length price, the tax saved by the importer is even greater, thereby creating a group net tax saving.
- Licensing the use of intellectual property - at above arm's length royalties - owned by a subsidiary in a low tax jurisdiction to one in a high tax jurisdiction. Research and development may have taken place in another jurisdiction, before ownership is transferred to the low tax jurisdiction (a chargeable gain may arise), so that royalty income is taxed at the lower rate (a net saving arises as above). Withholding taxes on royalty payments would need to be considered in the high tax paying subsidiary.
- Lending – at above arm's length interest rates - from a UK acquirer to an overseas subsidiary, located in a jurisdiction with a higher tax rate, to finance the cost of acquiring a target company: the effect would be the same as above. This assumes the overseas subsidiary has sufficient income to absorb the interest deduction or can relieve it against the target's profits (for example via the equivalent of the UK's group relief rules for tax losses).

Anti-avoidance TP rules adjust actual prices charged between related parties to arm's length equivalents for the purpose of calculating taxable profits (irrespective of whether there is a tax motive):

- "Individual group members must be taxed on the basis that they act at arm's length in their transactions with each other" [para.6 preface OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' January 2022].
- "Transactions between connected parties should be treated for tax purposes by reference to the amount of profit that would have arisen if the same transactions had been executed by unconnected parties. This is the arm's length principle." [HMRC INTM412040].

OECD guidelines on arm's length treatment can be found in Article 9 of the OECD Model and the 2015 Actions 8 – 10 Report ('Aligning Transfer Pricing Outcomes with Value Creation') of the Base Erosion and Profit Shifting ('BEPS') project (following the 2012 G20 meetings). UK legislation requires its own TP rules (contained in TIOPA 2010, Part 4: s146 – s217) to be interpreted in accordance with these OECD principles [s164 TIOPA 2010] (the Finance Act 2026 introduced some simplifications to the legislation). Many countries have also adopted the OECD TP principles.

⁷ Under condition 2 in reg 3(3) of S.I. 2004/3256: "The condition is that the currency in which the liability is expressed is such that the company intends, by entering into or continuing to be subject to that liability, to eliminate or substantially reduce the economic risk of holding the asset, or part of the asset, which is attributable to fluctuations in exchange rates. ... If condition 2 applies, a liability is matched with an asset only to the extent that the carrying value of the liability does not exceed the unmatched carrying value of the asset at the relevant time". [See CFM62640 and Example 1 in HMRC CFM62650].

Lending intra-group at an above arm's length rate would not result in an adjustment under the TP rules for the UK parent lender, since the TP rules only apply if "the actual provision confers a potential advantage in relation to United Kingdom taxation on one of the affected persons" [s147(2)(b) TIOPA 2010]. A 'potential advantage' arises when "the effect of making or imposing the actual provision, instead of the arm's length provision, would be that...a smaller amount...would be taken for tax purposes to be the amount of the person's profits for any chargeable period" [s155 TIOPA 2010]. The actual interest received on the loan to the overseas subsidiary would be taxed as a Non-Trading Loan Relationship Credit (Part 5 CTA 2009) at 25% (full UK rate 2026-27).

Borrowing intra-group by the overseas acquisition vehicle will be subject to TP rules if they apply there. The above-market interest charge would be reduced to an arm's length amount when calculating taxable profits, assuming the jurisdiction followed OECD principles, and the excess interest charge may be re-characterised as excessive interest and disallowed.

The procedure for a cross-border intra-group loan would typically include the following OECD approach:

- Analysis ('Accurate Delineation') - to determine arm's length terms and behaviour - of (1) the actual intra-group loan contract (a 'Controlled Transaction') to determine the rights, obligations and risks for lender and borrower, (2) other relevant documents, (3) the actual conduct of the parties, (4) the key functions performed by the lender (e.g. a credit risk assessment of the borrower) and (5) the 'options realistically available' to the lender (whether they would allocate financial resources to the borrower under the actual terms or lend/invest elsewhere to achieve its objectives and requirements). This shows the actual loan advanced and interest rate charged.
- An assessment of the arm's length interest charge "based on consideration of the credit rating of the borrower or the rating of the specific issuance taking into account all of the terms and conditions of the loan and comparability factors" [para. 10.89 OECD Transfer Pricing Guidance on Financial Transactions' February 2020]

The arm's length assessment would require the following:

- An analysis of the borrower's standalone credit risk (without parental guarantee support) to determine the arm's length interest rate based on market conditions ('Comparable Uncontrolled Price'). This might be based on a 'synthetic' credit rating an agency like Moody's might give. Protection for the lender in the form of financial covenants, security and parental guarantees (or implicit non-legal support) would need to be factored into the price.
- An estimate of the borrower's debt capacity based on interest coverage ratios. Intra-group debt concentrated in a high tax jurisdiction would increase the tax benefits from interest deductions. A subsidiary may be 'thinly capitalised' if lending by its parent is excessive (more than on an arm's length basis without parental support from guarantees and implicit support due to group membership). This step indicates the arm's length amount of debt that could be borrowed. The actual amount advanced in excess of this deemed market amount could be recharacterised as a capital contribution (equity).

Hybrid Mismatches

Tax mismatches between different tax jurisdictions resulting from cross-border 'Hybrid Arrangements' are targeted by 'Hybrid Mismatch' anti-avoidance rules (whether or not a mismatch was intended). For EU countries, these rules are contained in EU Anti-Tax Avoidance Directive 2016/1164 ('ATAD 1') as amended by 2017/952 ('ATAD 2'); in the UK, rules are found in Part 6A TIOPA 2010 (s259A – s259NF). In the UK, the TP rules and hybrid mismatch rules would be considered together – see HMRC INTM550085.

Mismatches include the following two cases:

- The payer (subsidiary) receives a tax deduction in country B but the receiver (parent) is not taxed in full in country A (either exempt or under-taxed because of the hybrid): 'Deduction without inclusion' (EU) or 'Deduction / Non-Inclusion' (UK). [Article 2 (9)(a)(e) EU 2016/1164, s259A(2) TIOPA 2010]. For example, payment of interest on a '*hybrid financial instrument*' that is characterised differently in country B (debt with deductible interest) and country A (equity with exempt dividend). Under EU rules, the interest deduction in country B is disallowed (if country B does not disallow it, then it would be taxed as income in country A) (the equivalent UK rules are s259C – s259CE Ch.3 TIOPA 2010).

Another example would be where a 'Hybrid Payer' (an entity taxed as a legally separate entity - 'tax opaque' – in B, but tax transparent and ignored in A) *borrows from the investor* to fund the acquisition of the target: the payer would normally obtain tax relief for the interest paid, but because it is transparent in country A the loan is ignored in the investor's jurisdiction (it cannot lend to itself). Under EU rules, the payer's deduction would be disallowed in country B to the extent that interest exceeds 'Dual Inclusion Income' (the payer's income, for example, from a trade, which would be taxed in country A and B); if country B does not disallow it, the payment is taxed as income in country A (the equivalent UK rules are s259E – s259ED Ch.5 TIOPA 2010).

- The payer in country B and parent / investor in country A each receive a tax deduction in respect of the same payment: 'Double Deduction' ('DD'). [Article 2 (9)(g) EU 2016/1164, s259A (3) TIOPA 2010] If the Hybrid Payer in the above example *borrows from a bank*, it would normally obtain tax relief for the external interest paid, but so would the parent / investor, since the payer is treated as the same entity as the parent (as it is transparent in country A).

Under EU rules, the parent's deduction would be disallowed in country A to the extent that interest exceeds dual inclusion income; if country A does not disallow it, the deduction in country B is denied for the payer (the equivalent UK rules are s259I – s259ICA Ch.9 TIOPA 2010).

Controlled Foreign Companies

A UK tax resident company acquiring an overseas target company directly or indirectly via an overseas intermediate holding company ('IHC') will need to consider the Controlled Foreign Companies ('CFC') rules in Part 9A (s371AA – s371VJ) TIOPA 2010. These rules allocate a share of the CFC's profits to the

relevant UK investor, subject to a number of tests. In broad terms, the assessment would involve the following steps:

- ① *Determine if the overseas company is a CFC.* A CFC is a non-UK resident company controlled directly or indirectly by a UK resident 'person or persons' (company or individual, 'P') [s371AA], using a number of legal, economic and control tests that include rights and powers held by P's associated enterprises [ch.18]. The acquirer will control the non-resident IHC and target in both acquisition structures (the target directly or indirectly), so these companies will qualify as CFCs.
- ② *Determine what exemptions apply.* Entities are exempt if any of the following apply:
 - a 12 month conditional exempt period from the date the CFC first comes within the CFC rules (to allow time to restructure) (ch.10)
 - the CFC is resident in an excluded territory and certain conditions are satisfied (see HMRC INTM224750 and SI 2012/3024) (ch.11): countries not on the list include Ireland, Switzerland, Cyprus, Jersey, Guernsey, Isle of Man, Cayman, BVI, Bermuda, Hong Kong, Singapore.
 - the CFC has low profits (no more than £50,000 or £500,000 total profits with non-trading income not exceeding £50,000)(ch.12)
 - the CFC has a low profit margin (pre-tax profits no more than 10% of operating expenditure)(ch.13)
 - the CFC local tax paid is at least 75% of the UK corporation tax that would arise on CFC profits (ch.14)
- ③ *Determine whether the CFC profits 'pass through the charge gateway'.* Consider Chapter 3 to determine which of Chapters 4 to 8 apply; consider the applicable Chapter to determine whether any profits pass through and, if so, how much (if Chapters 4 – 8 do not apply, the CFC profits are not considered any further and no charge will arise). Gateways include the following (Chapters 6 – 8 are not considered):
 - Profits attributable to UK activities. Under Chapter 3, Chapter 4 applies unless any of the conditions A-D in s371CA apply (if none is met, Chapter 4 determines whether, and how much profit, passes through). For example, condition B states: 'at no time during the accounting period, does the CFC have any UK managed assets or bear any UK managed risks' (those managed or controlled to any significant extent by way of relevant UK activities, including those of companies connected with the CFC). Under Chapter 4, profits are attributed (and pass through the charge gateway), very broadly and subject to exceptions, if generated by a UK-based 'significant people functions' ('SPFs').
 - Non-trading finance profits ('NTFP'). Under Chapter 3, Chapter 5 applies 'if (and only if) the CFC has non-trading finance profits' [s371CB] (subject to exceptions). Under Chapter 5, profits are

attributed if, as one example, NTFP are attributable to UK SPFs [s371EB] (75% partial relief may be given under ch.9 for qualifying loan relationship profits, under certain conditions, but not to the extent profits are attributable to UK SPFs).

- ④ *Apportion profits for charging.* The CFC profits that pass through the gateways and are not exempt are allocated to UK resident companies that have a relevant interest, held directly or indirectly, in the CFC of at least 25%, taking account of connected or associated persons.

Tax on Exit

A UK corporate acquirer may be entitled to exemption for tax on a gain on disposal under the Substantial Shareholding Exemption. This would apply if the UK acquirer sold shares it held in the target (direct acquisition) or shares in the intermediate holding company / 'IHC' (which owned the target – if the IHC sold the shares, any gain would depend on tax rules in its jurisdiction). There may be a local target jurisdiction tax charge on disposal.

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Suggested reading

UK Taxation

Books:

Chanda, S. & Hart, S. (2025) *Capital Gains Tax Reliefs for SMEs and Entrepreneurs 2025/26* Bloomsbury Professional Online
Miller, P., Hardy, G., Ismail, F. et al (2026) *Miller, Hardy and Ismail on Company Reorganisations* (7th ed.) Bloomsbury Professional Online
McLaughlin, M. (2025) *Tax Planning 2025/26* Bloomsbury Professional Online (10th ed.)
Rayney, P. (2026) *Rayney's Tax Planning for Family and Owner-Managed Companies* Bloomsbury Professional Online
Southern, D. (2017) *Taxation of Loan Relationships and Derivative Contracts* (10th ed.) Bloomsbury Professional Online
Squire Patton Boggs, (2015) *Tax Aspects of the Purchase and Sale of a Private Company's Shares* (24th ed.). Bloomsbury Professional.

Papers:

Appraisal Foundation (2019) 'Valuations In Financial Reporting Valuation Advisory 4: Valuation Of Contingent Consideration', 14 February 2019

Tax Legislation:

Corporation Tax Act 2009 (CTA 2009)
Corporation Tax Act 2010 (CTA 2010)
Taxation of Chargeable Gains Act 1992 (TCGA 1992)
Capital Allowances Act 2001 (CAA 2001)
Taxation (International and Other Provisions) Act 2010 (TIOPA 2010)
Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003)

Income Tax Act 2007 (ITA 2007)
Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005).

IFRS Accounting

Books:

Ernst & Young (2026) *International GAAP 2026* (available at: https://www.ey.com/en_gl/technical/ifrs-technical-resources/international-gaap-2026-the-global-perspective-on-ifrs)

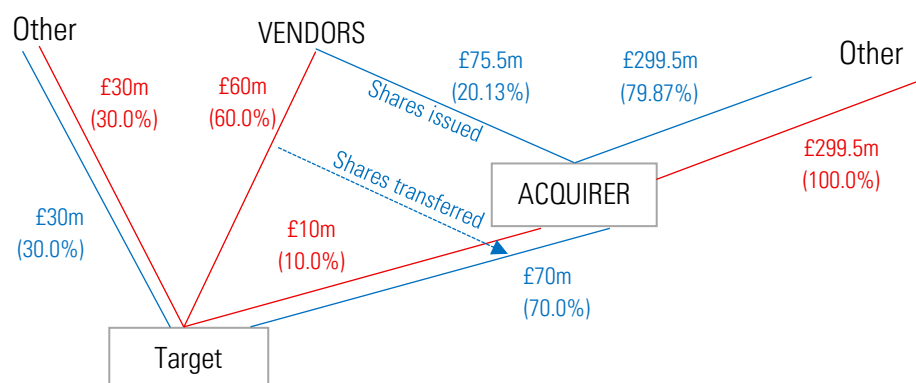
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A.I. Disclosure

The author wrote the article and built the Excel models. A.I. (Claude Opus 5 and Codex GPT-6 Astra) assisted with the following: (1) general: checking formulae, example arithmetic, cross references, citations and consistencies; (2) specific assistance: Hybrid mismatches, Controlled Foreign Companies, Corporate Interest Restriction reconciliation.

Appendix 1: Example - Exchanges (s135) and Conversions (s116)

In June 2020, Vendor (an individual - the Substantial Shareholding Exemption would not apply) purchased 30m shares in Target for £1.00 each, as well as £50m QCBs and £35m non-QCBs (total cost £115m). In June 2025, the value of its shares, QCBs and non-QCBs was £60m, £53m and £38m, respectively (total value £151m). Vendor exchanged these shares and securities in return for cash (£30.2m), shares (£75.5m), QCBs (£22.65m) and non-QCBs (£22.65m) in Acquirer. Acquirer's post-exchange holding was 70%, satisfying the shareholding condition in s135 TCGA 1992. Shareholding values and holdings before (red font) and after (blue font) the transaction are as follows:



Acquirer's pre-acquisition equity value is £299.5m, so a required £75.5m value for Vendor implies the issue of 37.813m new Acquirer shares (£75.5m / £299.5m x 150m shares). The post-acquisition equity value is £375m (£299.5m + £151.0m value acquired - £45.3m value of loan notes issued - £30.2m cash consideration).

Value	Target				Acquirer		
	Vendor	Other	Acquirer	Total	Vendor	Other	Total
<i>Numbers in £'000 unless stated otherwise</i>							
Pre-Acquisition							
Equity and loan note value	151,000	30,000	10,000	191,000	-	299,500	299,500
Less: QCB claims	(53,000)	-	-	(53,000)	-	-	-
Less: non-QCB claims	(38,000)	-	-	(38,000)	-	-	-
Equity Value	60,000	30,000	10,000	100,000	-	299,500	299,500
Holding	No.						
%	%						
	30,000	15,000	5,000	50,000		150,000	150,000
	60.00%	30.00%	10.00%	100.00%		100.00%	100.00%
Post-Acquisition							
Pre-acquisition equity value	60,000	30,000	10,000	100,000		299,500	299,500
Value of equity transferred	(60,000)		60,000		60,000		60,000
Target loan notes acquired (asset)					91,000		91,000
Less: new QCBs issued					(22,650)		(22,650)
Less: new non-QCBs issued					(22,650)		(22,650)
less: cash paid to vendor					(30,200)		(30,200)
Equity Value	-	30,000	70,000	100,000	75,500	299,500	375,000
Loan notes held after exchange			91,000		45,300		
Cash received by vendor					30,200		
Value			161,000		151,000		

The value of Vendor's interests transferred for cash, shares and loan notes in Acquirer is £151m, so the economic gain on exchange is £36m using the base cost of £115m, however £3m is allocated to

Vendor's exempt QCBs in Target, so the gain for tax is £33m, allocated as follows: £6.6m immediate chargeable gain for cash component (£7.2m - £0.6m QCB component), £4.95m is frozen against the new QCBs (£5.4m - £0.45m QCB component) and £21.45m is deducted off the base cost of the new shares and non-QCBs (£18m - £1.5m QCB component for shares and £5.4m - £0.45m QCB component for the non-QCBs).

The cost is allocated to the new holdings using market values, so that, for example, the £30m cost of shares in Target is allocated to the cash, Acquirer shares, Acquirer QCBs and Acquirer non-QCBs using the 20% cash, 50% shares, 15% QCBs and 15% non-QCBs consideration mix (a similar calculation is performed for the QCBs and non-QCBs Vendor held in Target).

Inputs in blue font
Numbers in '000 unless stated otherwise

GAIN AT DATE OF EXCHANGE									
Allocate Value at Exchange		In Target		Allocate Value in Acquirer					
		Value		Cash	Shares	QCBs	Non-QCBs	Total	
Shares held in Target	£	60,000	→	12,000	30,000	9,000	9,000	60,000	
QCBs held in Target	£	53,000	→	10,600	26,500	7,950	7,950	53,000	
Non-QCBs held in Target	£	38,000	→	7,600	19,000	5,700	5,700	38,000	
		151,000		30,200	75,500	22,650	22,650	151,000	
Consideration mix				20.00%	50.00%	15.00%	15.00%	100.00%	

Allocate Shareholdings at Exchange		Target				Acquirer			
		Vendor	Other	Acquirer	Total	Vendor	Other	Acquirer	Total
Pre- Exchange	No.	30,000	15,000	5,000	50,000		150,000		150,000
Exchange	No.	(30,000)		30,000	-	37,813			37,813
Post-Exchange	No.	-	15,000	35,000	50,000	37,813	150,000	-	187,813
Pre-Exchange Holding	%	60.00%	30.00%	10.00%	100.00%	0.00%	100.00%	0.00%	100.00%
Post-Exchange Holding	%	0.00%	30.00%	70.00%	100.00%	20.13%	79.87%	0.00%	100.00%
Value requirement	%/£	20.13%				75,500			375,000

Allocate original cost at exchange		In Target		Allocate original cost (gain analysis)					
		Cost		Cash	Shares	QCBs	Non-QCBs	Total	
Shares held in Target	Note 1	£	30,000	→	6,000	15,000	4,500	4,500	30,000
QCBs held in Target	Note 2	£	50,000	→	10,000	25,000	7,500	7,500	50,000
Non-QCBs held in Target	Note 1	£	35,000	→	7,000	17,500	5,250	5,250	35,000
		£	115,000		23,000	57,500	17,250	17,250	115,000

Calculate Gain at Exchange		In Target		Gain on Exchange of Target Instruments					
		Gain		Cash	Shares	QCBs	Non-QCBs	Total	
Shares held in Target	£	30,000	→	6,000	15,000	4,500	4,500	30,000	
QCBs held in Target	£	Exempt 3,000	→	600	1,500	450	450	3,000	
Non-QCBs held in Target	£	3,000	→	600	1,500	450	450	3,000	
		36,000		7,200	18,000	5,400	5,400	36,000	

Green cells show shares or non-QCBs exchanged for shares or non-QCBs. Assuming s135 and s137 conditions are satisfied, s127 treats these as the same asset: allocated original cost carries forward. Gains shown here are illustrative. QCBs exchanged for shares or non-QCBs instead give a market-value acquisition cost under s116.

Tax Treatment of Gain at Exchange	In Acquirer				In Acquirer			
	Cash		Shares		QCBs		Non-QCBs	
	TCGA 1992	Effect	TCGA 1992	Effect	TCGA 1992	Effect	TCGA 1992	Effect
Shares held in Target	s128(3), s122	Immediate	s127, s135	No Disposal	s116	Frozen	s127, s135	No Disposal
QCBs held in Target	s115	Exempt	s115, s116	Exempt	s115	Exempt	s115, s116	Exempt
Non-QCBs held in Target	s128(3), s122	Immediate	s127, s135	No Disposal	s116	Frozen	s127, s135	No Disposal

Note:

Shares/non-QCBs: cash gives an immediate gain; shares/non-QCBs retain original cost; a gain attributable to new QCBs is frozen until their disposal.

Original QCB gains are exempt, assuming no previously frozen gain. New shares/non-QCBs received for QCBs have market-value base cost.

In June 2026, Vendor disposed of all its shares and securities in Acquirer (equity value £500m). Vendor's holding in Acquirer (20.1%) realised £100.667m, the QCBs £25m and non-QCBs £25m. Including the cash received on exchange (£30.2m), Vendor realised £180.867m, giving a total gain compared to its original £115m investment in Target of £65.867m, before deducting the gains on exempt QCBs of £5.35m (£3m for the gains at the date of exchange for QCBs held in Target and £2.35m for post-exchange gains in QCBs held in Acquirer), giving gains of £60.517m (33.46% of proceeds).

GAIN AT DATE OF FINAL DISPOSAL

			In Acquirer				Total
			Cash	Shares	QCBs	Non-QCBs	
Cash Proceeds (A)	30/06/26		30/06/25		Exempt		
Shares originally held in Target	£		12,000	40,000	9,934	9,934	71,868
QCBs originally held in Target	£		10,600	35,333	8,775	8,775	63,483
Non-QCBs originally held in Target	£		7,600	25,333	6,291	6,291	45,516
			30,200	100,667	25,000	25,000	180,867
Value at Exchange Date (B)	30/06/25						
Shares originally held in Target	£		12,000	30,000	9,000	9,000	60,000
QCBs originally held in Target	£		10,600	26,500	7,950	7,950	53,000
Non-QCBs originally held in Target	£		7,600	19,000	5,700	5,700	38,000
			30,200	75,500	22,650	22,650	151,000
Gain for Post-Exchange Period	A - B						
Shares originally held in Target	£		-	10,000	934	934	11,868
QCBs originally held in Target	£		-	8,833	825	825	10,483
Non-QCBs originally held in Target	£		-	6,333	591	591	7,516
			-	25,167	2,350	2,350	29,867
Gain at Exchange Date	30/06/25						
Shares originally held in Target	£		6,000	15,000	4,500	4,500	30,000
QCBs originally held in Target	£		600	1,500	450	450	3,000
Non-QCBs originally held in Target	£		600	1,500	450	450	3,000
			7,200	18,000	5,400	5,400	36,000
Total Gain							
Shares originally held in Target	£		6,000	25,000	5,434	5,434	41,868
QCBs originally held in Target	£		600	10,333	1,275	1,275	13,483
Non-QCBs originally held in Target	£		600	7,833	1,041	1,041	10,516
			7,200	43,167	7,750	7,750	65,867
less: exempt QCBs (held in Target originally): at exchange			(600)	(1,500)	(450)	(450)	(3,000)
less: exempt QCBs (held in Acquirer): post-exchange					(2,350)		(2,350)
Total chargeable gain			6,600	41,667	4,950	7,300	60,517
Gain as % of Disposal			21.85%	41.39%	19.80%	29.20%	33.46%
Chargeable gain at exchange	30/06/25	£	6,600				
Chargeable gain on final disposal	30/06/26	£		41,667	4,950	7,300	

If Vendor had instead received 100% of its £151m value at exchange in the form of shares in Acquirer, it would have a 33.518% share of the Acquirer's £450.5m equity value (£299.5m pre-acquisition value + £151.0m value acquired) at the June 2025 exchange value. Assuming Acquirer's equity value was £580.2m in June 2026 at the date of disposal (taking into account the £30.2m cash not paid out and £50m disposal date fair value of the loan notes not issued), Vendor would have received £194.473m proceeds (vs. £180.867m for the agreed mix) and had gains of £76.473m.

Reconciliation to 100% share scenario

		In Acquirer				
		Cash	Shares	QCBs	Non-QCBs	Total
<i>Proceeds:</i>						
Value at exchange	£	30,200	75,500	22,650	22,650	151,000
Actual post-exchange gain (including exempt)	£	-	25,167	2,350	2,350	29,867
Actual proceeds	£	30,200	100,667	25,000	25,000	180,867
Value at exchange	£	30,200	75,500	22,650	22,650	151,000
Post-exchange gain if 100% shares in Acquirer	£	8,695	21,737	6,521	6,521	43,473
Proceeds if 100% shares	£	38,895	97,237	29,171	29,171	194,473
<i>Gains:</i>						
Gain with mix chosen	£	6,600	41,667	4,950	7,300	60,517
less: non-share gains	£	(6,600)		(4,950)	(7,300)	(18,850)
Gain adjustment if all shares	£	15,295	(3,430)	11,471	11,471	34,807
Gain if 100% shares issued	£	15,295	38,237	11,471	11,471	76,473
All-share alternative (same business)						
Exchange Value	£	30,200	75,500	22,650	22,650	151,000
Holding (post-exchange equity £450.5m)	%	6.70%	16.76%	5.03%	5.03%	33.52%
Required Shares	No.	15,125	37,813	11,344	11,344	75,626
Disposal equity (£580.2m)	28.79% £	38,895	97,237	29,171	29,171	194,473
Tax base cost (QCB market-value uplift)	£	(23,600)	(59,000)	(17,700)	(17,700)	(118,000)
Gain - assuming shares issued and not cash, QCBs or non-QC		15,295	38,237	11,471	11,471	76,473
Gain as % of Disposal		39.32%	39.32%	39.32%	39.32%	39.32%

All-share alternative retains the cash payment and avoids issuing the new notes. Add both to Acquirer equity, at exchange and exit. The original QCB element receives market-value tax cost. No cash return, financing interest, costs or synergies are assumed.

Appendix 2: Example – UK Taxation of Earn-out

An individual vendor is selling 100% of their shareholding in a trading company (cost £50m) for £300m paid at the date of acquisition plus 3 further payments that are either fixed and certain (£75m paid annually starting in one year after the date of acquisition T_0) or variable and contingent on the level of EBITDA reaching a threshold in each of the next three years.

The first scenario will require deferred cash to be added (without any discounting) to upfront cash, producing an immediate taxable gain of £475m ($= £300m + 3 \times £75m - £50m$). Calculation of the taxable gain for the second scenario will use the methodology established in *Marren v Ingles* (1980) for unascertainable deferred consideration. In this scenario, the vendor will receive earn-out payments at times 1, 2 and 3 (T_1, T_2, T_3) equal to a multiple ($\times 1.0, \times 1.2$ and $\times 1.3$, respectively) of EBITDA contingent on EBITDA reaching a threshold of £100m, £115m and £120m, respectively. A valuation of the remaining future earn-out payoffs at each date will be required for calculation of the gain at the date of acquisition and gain at each payment date.

At T_0 Expected earn-out payments of £100m, £144m and £169m at T_1 , T_2 and T_3 respectively are assumed for this illustration. These are discounted at an illustrative 10% to T_0 give a present value of £336.89m. Assuming this is the agreed market value of the earn-out right, a gain of £586.89m arises (£300m upfront consideration + £336.89m - £50m base cost).

At T_1 Year 1 actual EBITDA is £95m, so the T_1 payout is not triggered as it has not reached £100m. The revised estimates for EBITDA for T_2 and T_3 are £120m and £125m, giving an earn-out value of £265.21m, but this is not used in the calculation, since no part disposal is made.

At T_2 Year 2 actual EBITDA is £118m, so the T_2 payout is triggered (£141.6m = £118m $\times$ 1.2). The estimate for EBITDA for T_3 remains at £125m, giving an expected £162.5m payout, valued at £147.7m ($= £125m \times 1.3 / 1.10$). The capital gain on receipt of the earn-out payment will be based on an apportionment of the full earn-out initial amount (since none was used at T_1 because there was no payment) using the part disposal formula, calculated as follows: £141.6m – £164.9m [$= (£336.89m \text{ initial value} - \text{£nil allocated to } T_1) \times £141.6m / (£141.6m + £147.7m)$] = £23.3m capital loss.

At T_3 Year 3 actual EBITDA is £128m, so the T_3 payout is £166.4m and capital loss £5.6m ($£166.4 - [(£336.89m \text{ initial value} - \text{£nil allocated to } T_1 - £164.9m \text{ allocated to } T_2)]$).

The total gain under scenario 2 = T_0 gain (£586.89m) + T_1 gain (£nil) - T_2 loss (£23.3m) - T_3 loss (£5.6m) = £558m. This will always be equal to actual cash received – base cost ($= £300m \text{ up front} + T_2 \text{ payment } £141.6m + T_3 \text{ payment } £166.4m - £50m \text{ cost} = £558m$). The vendor is taxed at completion on a gain of £586.89m, despite receiving only £300m in cash.

As the vendor is an individual, an election can be made to treat the capital losses in years 2 and 3 as if they arose in the same year as the earlier gain (they would be set-off to produce a net gain of £558m in the tax year in which the date of acquisition occurs) [s279A-s279D TCGA 1992].

To simplify the valuation, since the focus is on tax treatment, an option pricing approach, which would be suitable for a non-linear payoff like this – see example 9.4 on line 3006 Appraisal Foundation (2019) – is not being used.

					<i>All figures in millions</i>			
					GAIN			
					Consid.	Base Cost	Gain	
						Shares	Earn-out	
As at 30 June 2026 (T0):								
Cash on disposal	47.10 %	300.00						
Earn-out value	52.90 %	336.89						
Consideration		636.89						
Cost		(50.00)						
Gain		586.89	636.89	(50.00)	-	586.89		
As at 30 June 2027 (T1):								
Earn-out cash (C1)	0.00 %	-						
Remaining Earn-out value	100.00 %	265.21						
Earn-out value		265.21						
Initial value remaining		(336.89)						
x Earn-out part disposal %	336,890 x 0.00%	-						
Gain	= 0 - 0	-	-		-	-	-	-
As at 30 June 2028 (T2):								
Earn-out cash (C2)	48.94 %	141.60						
Remaining Earn-out value	51.06 %	147.73						
Earn-out value		289.33						
Initial value remaining	336,890 - 0	(336.89)						
x Earn-out part disposal %	336,890 x 48.94%	(164.88)						
Gain	141,600 - 164,878	(23.28)	141.60	(164.88)	(23.28)			
As at 30 June 2029 (T3):								
Earn-out cash	100.00 %	166.40						
Remaining Earn-out value	0.00 %							
Earn-out value		166.40						
Initial value remaining	336,890 - 164,878	(172.01)						
x Earn-out part disposal %	172,012 x 100.00%	(172.01)						
Gain	166,400 - 172,012	(5.61)	166.40	(172.01)	(5.61)			
Total					944.89	(50.00)	(336.89)	558.00

All figures in millions

	EARN-OUT							
	Expected Earn-out			PV Expected Earn-out			Actual EBITDA	Actual Earn-out
	At T0	At T1	At T2	10.0 % At T0	Discount rate At T1	At T2		
As at 30 June 2026 (T0):								
Cash on disposal								
Earn-out value								
Consideration								
Cost								
Gain								
As at 30 June 2027 (T1):								
Earn-out cash (C1)	100.00			90.91			95.00	-
Remaining Earn-out value								
Earn-out value								
Initial value remaining								
x Earn-out part disposal %								
Gain								
As at 30 June 2028 (T2):								
Earn-out cash (C2)	144.00	144.00		119.01	130.91		118.00	141.60
Remaining Earn-out value								
Earn-out value								
Initial value remaining								
x Earn-out part disposal %								
Gain								
As at 30 June 2029 (T3):								
Earn-out cash	169.00	162.50	162.50	126.97	134.30	147.73	128.00	166.40
Remaining Earn-out value								
Earn-out value								
Initial value remaining								
x Earn-out part disposal %								
Gain								
Total				336.89	265.21	147.73		308.00

Figures in '000s

ASSUMPTIONS					
		T0	T1	T2	T3
		30 Jun 2026	30 Jun 2027	30 Jun 2028	30 Jun 2029
Base cost of shares	£	50,000			
Ascertainable Consideration - upfront	£	300,000			
Ascertainable Consideration - deferred	£		75,000	75,000	75,000
EBITDA threshold	£		100,000	115,000	120,000
Contingent deferred consideration (x EBITDA)			x 1.000	x 1.200	x 1.300
At T0 expected EBITDA	£		100,000	120,000	130,000
At T1 expected EBITDA	£			120,000	125,000
At T2 expected EBITDA	£				125,000
At T0 expected earn-out payment	£		100,000	144,000	169,000
At T1 expected earn-out payment	£		-	144,000	162,500
At T2 expected earn-out payment	£		-	-	162,500
Actual EBITDA	£		95,000	118,000	128,000
Unascertainable Consideration (actual)	£		-	141,600	166,400

Appendix 3: CIR Definitions & Example

Interest Reconciliation		TIOPA 2010
LR Debits [A] - excl. LR forex and FV impairment exceptions	x	s383
Derivative Debits [B] [IR, currency A/L only] - excl. forex and impairment	x	s384
Finance charges [C]: finance lease, debt factoring, repos etc	x	s382
Less: qualifying Infrastructure Company expense amounts	(x)	s432-449
Tax Interest Expense	x	
LR Credits	x	s385,386
Derivative Credits	x	s385,387
Finance income on relevant arrangement transactions	x	s385
Debt guarantee fees	x	s385
Less: qualifying Infrastructure Company income amounts	(x)	s432-449
Tax Interest Income	(x)	
Aggregate Net Tax Interest Expense [ANTIE]	x	s389, s390
Relevant Expense Amount	x	s410-412
Relevant Income Amount	(x)	
Net Group Interest Expense (NGIE)	X	s410
Add: Upward Adjustments	x	
Less: Downward Adjustments	(x)	
Adjusted Net Group Interest Expense (ANGIE)	x	
Share of Associates ANGIE if non-consolidated investment election made	x	
Adjusted Net Group-Interest Expenses (ANGIE)	X	s413
Less: Downward Adjustments		
• Relevant expenses for related party transactions	(x)	
• Payments for results-dependent securities	(x)	
• Equity Note payments	(x)	x
Qualifying Net Group Interest Expense (QNGIE) (Worldwide Group)	X	
EBITDA Reconciliations		
Group Pre-Tax Profit	x	s416
+ NGIE	x	s416
+ Depreciation, Amortisation, Impairment on Relevant Assets ¹	x	s417
+ / - Fair value movements on Relevant Assets ¹ measured at FV	x	s418
+ / - Losses/(Gains) on disposals of Relevant Assets ¹	x	s419
- R & D Expenditure Credit	(x)	s416
Group EBITDA	x	
- EBITDA for Qualifying Infrastructure Companies (QICs) in group	(x)	
Group EBITDA (Worldwide Group)	x	
Taxable Total Profits for period	x	s406
+ / - Excluded amounts:		s407
- tax-interest expense or income amounts	x/(x)	
- capital charges or allowances under CAA 2001	x/(x)	
- excluding capital expenditure under s407(1A)	x	
- excluded relevant intangibles debit or credit	x/(x)	
- a non-capital loss before or after the current period	x	
- a LR deficit before or after the current period	x	
- expenses of management before or after current period	x	
- group relief for losses of the worldwide group	x	
- a qualifying tax relief	x/(x)	(x)
Less: Deductions unused because of insufficient profits under s406(4)	(x)	
Tax EBITDA (UK tax companies)	x	s372,405-406

¹ "Relevant assets" include:

- Property, plant and equipment,
- an investment property,
- an intangible asset
- goodwill
- shares in a company, or
- an interest in an entity which entitles the holder to a share of the profits of the entity.

Example: CIR

A company incurs £10.9m of net interest costs (ANTIE) and has tax-EBITDA of £12.9m. Its ANGIE, QNGIE and Group EBITDA are £9.8m, £9.8m and £30.65m. The FRIA 30% ratio is less than the GRP 31.97% (£9.8m / £30.65m), so the borrower elects for GRIA. Interest Capacity is £4.125m (=31.97% x £12.9m tax-EBITDA), and the Disallowed Amount £6.775m (£10.9m - £4.125m).

INTEREST RECONCILIATION			
			<i>TIOPA 2010</i>
LR Debits	12,000		s383
Derivative Debits	1,500		s384
Tax Interest Expense		13,500	
LR Credits	2,000		s385,386
Derivative Credits	600		s385,387
Tax Interest Income		2,600	
AGGREGATE NET TAX INTEREST EXPENSE [ANTIE]		10,900	s389, s390
Interest payable under a LR and relevant non-lending relationship	12,500		
Relevant Expense Amount		12,500	s410-412
Relevant Income Amount (income version of all above)		(3,350)	
NET GROUP INTEREST EXPENSE (NGIE) or Net Group Relevant Expense		9,150	s410
<i>Add: Upward Adjustments:</i>			
Relevant expenses included in carrying value of A/L	500		
Relevant expenses not recognized in P&L or OCI	200		
Capitalised relevant income written off	100		
Relevant income not permitted under s322-323 CTA 2009	150	950	s413
<i>Less: Downward Adjustments</i>			
Relevant income included in carrying value of A/L	(300)	(300)	
ADJUSTED NET GROUP-INTEREST EXPENSES (ANGIE)		9,800	s413
<i>Less: Downward Adjustments</i>			
Relevant expenses for related party transactions	-		
Payments for results-dependent securities	-		
Equity Note payments	-	-	
QUALIFYING NET INTEREST EXPENSES (QNGIE)		9,800	s414

EBITDA RECONCILIATIONS			
			<i>TIOPA 2010</i>
Group Pre-Tax Profit	12,000		s416
+ NGIE	9,150		s416
+ Depreciation, Amortisation, Impairment on Relevant Assets ¹	8,000		s417
+ / - Fair value movements on Relevant Assets ¹ measured at FV	1,000		s418
+ / - Losses/(Gains) on disposals of Relevant Assets ¹	500		s419
GROUP EBITDA		30,650	
Taxable Total Profits for period		2,000	s406
+ / - <i>Excluded amounts:</i>			s407
Tax-interest expense / income amount	10,900		
ANTIE		10,900	
TAX EBITDA (Adjusted Corporation Tax Earnings)		12,900	s372, 405-406

DISALLOWANCE CALCULATION

	FRM	GRM
Relevant Expenses	12,500	
Relevant Income	(3,350)	
NGIE	9,150	
+ / - Adjustments	650	
ANGIEt	9,800	9,800
- Adjustments - (only)		-
QNGIEt		9,800
Group Ratio Percentage = QNGIE / group-EBITDA _t		32.0%
[A] Debt Cap	9,800	9,800
[B] 30% or GRPt x Tax-EBITDA _t	3,870	4,125
Basic Interest Allowance (lower of A or B)	3,870	4,125
+ Net Tax Interest Income (if any)	-	-
Interest Allowance (IA_t)	3,870	4,125
Interest Capacity (IC) [min £2m de minimis]	3,870	4,125
 <i>Basic Interest Allowance = higher of FRM / GRM</i>		
Interest Allowance (IA _t)		4,125
Interest Capacity (IC)		4,125
ANTIE		10,900
Total Disallowed Amount ('DA' = ANTIE - IC)		6,775