INTRODUCTION

This article discusses the form, structure and treatment of consideration for the sale and purchase of a UK based business, principally via the acquisition of a majority holding of unquoted shares in a target company that owns the business (share sale), rather than the trade and assets direct from that company (assets sale). It adopts a cross-disciplinary approach, discussing topics relevant to corporate finance (including valuation), UK tax (2026-27 capital gains) and financial reporting (IFRS) as they apply to consideration:

- **Part 1** ('Valuation – Price – Consideration') discusses the link between Intrinsic Value (the subject of the article 'Business Valuation – Part 1: Cash Flows and Value'), price and consideration, including minority and majority private or public valuations, synergies, the offer price range, share-for-share Exchange Ratios and deferred contingent consideration ('Earn-outs').

- **Part 2** ('UK Tax Treatment of Consideration: Vendor') introduces the principles of UK taxation of capital gains and discusses how the different forms of consideration are taxed in the hands of a UK tax resident vendor, what capital gains reliefs are available under the share-for-share exchange and reorganisation rules and what exemptions and tax rate reliefs are possible (Substantial Shareholding Exemption, Business Asset Disposal Relief).

- **Part 3** ('IFRS Financial Reporting Of Acquisition Consideration: Acquirer') discusses how a corporate acquirer recognises consideration as part of a Business Combination under IFRS, and how it affects other components treated under the Acquisition Method of accounting. Step-up acquisitions are also discussed, showing how consideration is treated as an investor increases its holding from Equity Investment to Associate to Subsidiary level.

Examples relating to each Part are included as Appendices.

Valuation

Intrinsic Value

The Discounted Cash Flow ('DCF') valuation technique is the standard approach to estimating the Intrinsic Value of a business ('Enterprise Value' / 'EntV'), independent of how that business is financed. The EntV is value that is shared between the providers of financial capital for the business, directly or indirectly, one class being ordinary shares, the subject of this article. The 'Equity Value' / 'EqV', as discussed in the Business Valuation articles (Parts I – III), will form the basis of the Intrinsic Value per Ordinary Share calculation, after all other claims are deducted off EntV (as part of the EntV-EqV 'Bridge', including convertible bonds, preference shares and employee options, discussed in the Security Valuation articles).

Premium / Discount

Since a majority shareholder would normally be able to control how the directors and shareholders voted, it would have the power to determine operating, investment and financing decisions. An investor achieving control of a company would be able to implement efficiency and value enhancing measures not currently envisaged by management, so that it would be prepared to pay a 'Control Premium' to increase the 'as-is' value to reflect control under its direction ('Control Value' / $V_{CONTROL}$). The value of control can be compared to value without control as follows:

$$V_{CONTROL} = V_{MINORITY} \times (1 + \text{Control Premium \%})$$

$$V_{MINORITY} = V_{CONTROL} \times (1 - \text{DLOC \%})$$

$$\text{where DLOC \%}^{*} = \text{Control Premium \%} \;/\; (1 + \text{Control Premium \%})$$

* 'Discount for Lack Of Control' or 'Minority Discount'

A quoted share that can be traded quickly in a 'liquid' market would have more value than an otherwise identical holding in a non-marketable share, which would require a 'Discount for Lack Of Marketability' ('DLOM'):

$$V_{NON\text{-}MARKETABLE} = V_{MARKETABLE} \times (1 - \text{DLOM \%})$$

A minority quoted holding will be both marketable *and* liquid, a majority quoted holding may not: "a 100 percent control interest in a public company is marketable but not liquid" [p.513 Hitchner (2025)] since, given the large block of shares being offered, it may not be sold quickly for cash. A minority holding in a private company may not be marketable, whereas a majority holding would be, but neither would be liquid: "a controlling ownership interest in a privately held business is not liquid" [p.513

Hitchner (2025)]. Various studies have been undertaken to estimate the premium and discount [see ch.10 Hitchner (2025), ch.17-19 Pratt (2022), ch.15 Trugman (2017)].

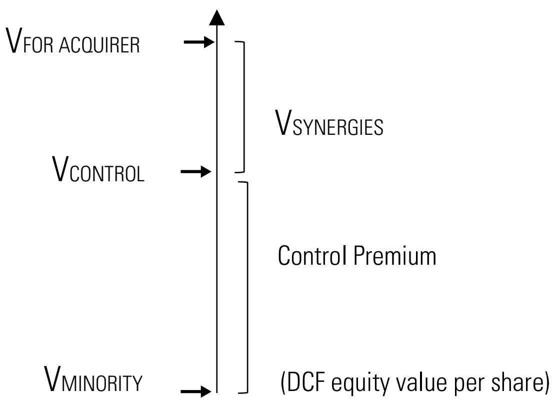
Value before any premium or discount

Value therefore increases up various 'levels of value': minority, non-marketable → minority, marketable → control, non-marketable → control, marketable. The question is where a DCF equity value (the starting value) would sit in this hierarchy and what adjustments are required. If the cost of equity used in the discount rate incorporates market inputs (when estimating the equity beta and Equity Risk Premium) the resulting value, it is argued, will reflect a marketable holding. If the cash flows do not include any adjustments that a controlling shareholder might make, but are based on management forecasts, for example, the valuation would be for a minority holding.

This would suggest the starting DCF EqV produces a minority / marketable value (an 'as-is' traded value, similar to a quoted share price[1]) [see p.518 Hitchner (2025), p.572 Trugman (2017)]. If cash flows are improved via adjustments for control, the Control Value would represent a majority / marketable value (which would incorporate the Control Premium a seller would expect). A DLOM would then be applied, if appropriate, for a non-marketable / majority (control) value (some argue the DLOM should not be applied in full – see p.509 Hitchner (2025)). This would give the value of a private company with control (this assumes there is no change to the discount rate from the initial starting value, which will not be the case if private company risk adjustments are made to the CAPM cost of equity).

Obtaining control may bring other incremental net benefits in the merged business from revenue growth, cost reductions and investment efficiencies ('Synergies'), net of any costs to achieve these. This would be the final value adjustment for an acquirer ($V_{SYNERGIES}$).

The total value to the acquirer (ignoring any marketability discount)('Strategic Control Value') gives the acquirer's maximum price before the acquisition would be value destructive:



[1] Some argue a quoted price does not reflect a minority value [see p.528 Hitchner (2025)]. This article assumes that it does and that the DCF equity value per share (without control) is the private equivalent of a quoted price

Price

The owner of a business would estimate the EntV and EqV based on existing management's business plans and cash flow projections (normalised and sustainable). The estimated value would be from a seller/vendor's perspective, since it provides evidence of Intrinsic Value on an 'as-is' standalone basis (V_S), and represents the vendor's minimum price it would accept from the acquirer (P_{MIN_s}).

The acquirer would also perform its own valuation, using target management forecasts (up to 3 years, say), if made available, making its own assumptions for projected cash flows beyond these (it would not normally know what the vendor had assumed). It would also make its own adjustments if it considered management's estimates over-optimistic or insufficiently normalised. This gives the acquirer's as-is valuation (V_P). It would then add in value for control and synergies.

Both vendor and acquirer would analyse comparable transaction and trading multiples, adjusting for DLOM and the control premium (a transaction multiple would already incorporate a premium if it related to a majority acquisition). This would provide support for the DCF valuations, as well as allow the acquirer to compare them to the multiple implied from its offer price.

Consideration

Introduction

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[1]: 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.

1 Corporation Tax Act 2009 (CT 2009), Corporation Tax Act 2010 (CT 2010), Taxation of Chargeable Gains Act 1992 (TCGA 1992), Capital Allowances Act 2001 (CAA 2001), Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003), Taxation (International and Other Provisions) Act 2010 (TIOPA 2010), Income Tax Act 2007 (ITA 2007) & Income Tax (Trading and Other Income) Act 2005 (ITOIA 2005).

Cash vs. Non-Cash

In a public takeover, the target shareholders would expect an acquirer to pay a control premium over the pre-bid rumour price (or average of prices), as discussed above. The premium cost would represent a payment for control value and synergies (a premium value), on the basis that the trading price represented a minority holding value.

In a share-for-share exchange, there is no outflow of cash that would otherwise, theoretically, reduce the value of the combined entity. The benefits from the acquisition would equal the premium value ($NPV_{100\%Share}$), and the merged value would be: $V_A + V_T + NPV_{100\%Share}$. The premium value would be shared between the shareholders of the acquirer and target (vendor), depending on how many shares are issued (the risk of the premium value not being achieved is shared).

In a cash transaction, the gains would in theory equal the premium value less premium cost ($NPV_{100\%Cash} = NPV_{100\%Share}$ - premium cost paid in cash). The merged value would be: $V_A + V_T + NPV_{100\%Share}$ – premium cash paid. The premium value risk is borne entirely by the acquirer shareholders.

For a quoted acquirer, the cash-shares mix will affect the reported Earnings Per Share ('EPS' = net income / shares), either positively ('accretion') or negatively ('dilution') from the combined effect of net financing costs (relating to the cash component) and additional shares being issued.

Exchange Ratios

In a share-for-share exchange, the Exchange Ratio ('ER') represents the number of shares in the acquirer the vendor will receive for each share it holds in the target. With a 'Fixed' ER, the number of shares issued on closing is certain, but the target shareholders bear the risk of receiving shares of less value if the acquirer price falls between the offer and completion dates (fixed shares, floating value). With a 'Floating' ER, the number of shares issued depends on the closing share price (variable shares, fixed value), and the acquirer now bears the risk of price movements.

A 'collar' may be used so that the value for the vendors varies within an acquirer share price range but is fixed outside this range ('Fixed Exchange Ratio Collar') or the value is fixed within this range and varies outside of it ('Fixed-Price Collar'). The minimum and maximum fixed ER will reflect which party receives all the NPV (shareholders of the acquirer for the minimum, shareholders of the target for the maximum).

See Appendix 1 for further discussion on how a fixed ER is set, illustrated with an example.

Payment of Consideration

Cash paid on completion

The agreed sale price may be conditional on assumptions about net assets and/or working capital that need to be verified in accounts, prepared in accordance with the Sale and Purchase Agreement, as at the completion date ('Completion Accounts') or before ('Locked Box Accounts' prepared at the 'Locked Box Date'); in the latter, the buyer will want to minimise any 'leakage' from that date to completion. There may be other consideration adjustments.

Deferred consideration ('Earn-out')

Use of Earn-Out

An Earn-out is an agreement that part of the consideration will not be paid on completion but be deferred and paid (in cash, shares, securities) over an agreed period (usually 2 – 3 years) depending on the target achieving agreed milestones or financial metrics (single or multiple), such as Earnings Before Interest Tax Depreciation and Amortisation ('EBITDA'). Non-financial metrics may also be used, particularly in those sectors where future events affect value at the disposal date (such as clinical trials, regulatory approval, etc.).

The acquirer will assume in its DCF or multiples valuation that the target is able to achieve certain 'value drivers' (such as EBITDA growth) during the first few years when forecasting is more reliable. The risk of these drivers not being achieved may depend on the continued involvement of key personnel in the target business (particularly an owner-manager). An earn-out would pass this risk to the vendor, since no deferred consideration would be paid if, for example, EBITDA had not reached its threshold (if structured in this manner). If the vendor's assumptions are more optimistic than the acquirer's (leading to a 'valuation gap'), an earn-out would also allow the acquirer to wait and see if the vendor's assumptions are achieved over the deferral period.

Risks of Earn-Out

In an Earn-out, the vendor is agreeing to transfer ownership of the target to the acquirer in exchange for some of the consideration being deferred and contingent on business performance over which it will no longer have control. It is therefore exposed to the relevant metric: (1) not being achieved because of the actions of the acquirer (who will not want to pay any deferred consideration), (2) being achieved in its opinion but not in that of the acquirer (dispute over definition - particularly where not defined elsewhere in statute or financing reporting standards - and/or calculation, although external auditors would decide the latter) and (3) being achieved and agreed by all parties but not being paid due to the default of the acquirer. These are risks that can be managed with a well drafted Sale and Purchase Agreement ('SPA')(metric definition) and third party guarantee or support (for the acquirer default risk).

Valuation of Earn-Out

An Earn-Out value needs to be determined for tax and financial reporting reasons. Since the deferred payments are contingent on future events, the appropriate valuation technique will depend on how the metric triggers a 'pay-off', particularly whether it is 'linear' (e.g. x% of EBITDA in year 1) or 'non-linear' (e.g. x% of EBITDA in year 1 in excess of an amount £Y with or without a cap). The US Appraisal Foundation ('Reporting Valuation Advisory No.4 - Valuation of Contingent Consideration', February 2019) recommends using the 'Scenario Based Method' ('SBM') for linear structures and the 'Option Pricing Method' ('OPM') for non-linear structures. The SBM requires selected scenarios to be chosen for the metric (e.g. low, base and high cases), probabilities assigned to each (the sum of probabilities must equal 1.0) and payoffs to be determined. The probability weighted payoff would be discounted to PV (risk free rate plus $\text{premium}_{\text{SBM}}$). The OPM can value complex capital structures, using option pricing models (see the article 'Security Valuation: Using the Option Pricing Method for Complex Capital Structures' for further discussion).

An earn-out payment calculated as a percentage or multiple of EBITDA in excess of a threshold amount would be valued as a call option, since a payoff only arises if EBITDA (the equivalent of the share price in a financial call option model) increases above the threshold (the exercise price). The probability-weighted expected payoffs would be discounted to obtain the PV (risk free rate plus $\text{premium}_{\text{OPM}}$). In both models, the discount rate should reflect the risk of the metric, the payoff and the acquirer default risk (further discussion can be found in the Appraisal Foundation's guide).

PART 2: UK TAX TREATMENT OF CONSIDERATION (VENDOR)

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

Consideration is not defined in the legislation for gains purposes, but 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].

If the sale is not deemed to have been made at arm's length, the market value at the disposal date will be substituted for the actual disposal proceeds. This will arise if the vendor and purchaser are 'connected' (this would include companies in the same group and under common control, as well as individuals who are married or in a civil partnership and their relatives and partners in a partnership) [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.

Chargeable Gain

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] together with an indexation allowance for inflation up to 31 December 2017 for companies and 5 April 2008 for individuals [s53-55 TCGA 1992]). A capital loss will arise if this produces a negative number (although indexation cannot increase or create a loss). 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 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 gain (after the annual exemption) is taxed at 24% for higher rate taxpayers (combined income and gains exceeding the £37,700 upper limit of the basic rate band). Gains would form part of a company's taxable profits, taxed (2026-27) at 25% (for small companies the 25% would be tapered down by marginal relief to 19%, depending on the amount of profits).

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 put 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; s171 intra-group asset transfers (that become taxable on certain 'de-grouping' events); and s116 exchanges involving QCBs and non-QCBs. These categories are discussed below.

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% of the market value - 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) 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, or eliminate them completely. Advance clearance procedures are stated in s138 TCGA 1992.

Shares → QCB

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….'. An asset held by a company that represents a 'Loan Relationship' [Parts 5 and 6 s292-569 CTA 2009] will be a QCB [s117(A1) TCGA 1992]. For individuals, a QCB is broadly a secured or unsecured UK Sterling corporate bond (with no rights to convert to another currency) carrying a commercial rate of return [see HMRC CG53702P]. Under s117(1) TCGA 1992, a "corporate bond" 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'. 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 is disapplied under s116(5) TCGA 1992. However the gain is not taxed at the date of exchange but is '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 off 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 2 Example 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_o 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 above), the gain at the disposal date would be equal to $C_o + V_{0E}$ – 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 Example 2.

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: (1) 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 the business or assets of the issuing company or a member of the same group), (2) no cash earn-out payments can be made, only shares / debentures and (3) 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. Since 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 by the acquirer. The terms of the earn-out agreement must prevent 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 ERSM110940.

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).

Individual vendors who would otherwise obtain a capital gains tax reduction under BADR rules, cannot benefit from the lower rates in respect of earn-out rights, since the future gains are in respect of the earn-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).

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.

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.

Normally, if the transferee (newco) leaves the group (when the vendor disposes of it) within 6 years of the transfer date ('de-grouping'), any gain at the date of the original transfer would become taxable [s179 TCGA 1992]. This gain is calculated on the assumption the asset was sold and immediately re-acquired at the transfer date at market values. Similar rules apply to the intra-group transfer of intangible assets [s764 – 799 CTA 2009]. If SSE applies on the sale of newco to the acquirer, the hypothetical sale and purchase exercise is instead carried out at the sale date and the gain is added to the consideration received by the vendor for the sale of newco, however both consideration for the sale of shares and the de-grouping gain would be exempt under SSE [para.38 Sch.7AC TCGA 1992]. The setting up of newco will not affect the SSE 12 month continuous holding period requirement since para.15A Sch. 7AC TCGA 1992 includes the period where the vendor owns newco as well as the period it owned the target (because they were members of the same group). See HMRC CG53080C

As for BADR, the SSE will not apply to earn-out payments, since they are not in respect of shares.

PART 3: IFRS FINANCIAL REPORTING OF ACQUISITION CONSIDERATION (ACQUIRER)

Introduction to Business Combinations

The recognition of consideration paid to acquire a company in the financial statements of the acquirer prepared under International Accounting Standards 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 (often, but not always, where more than 50% of the voting rights are purchased), will be accounted for under the 'Acquisition Method' and the target company consolidated as a subsidiary under IFRS 3. 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:

(1) the investor is exposed, or has rights, to <u>variable returns</u> 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); <u>and</u>

(2) the investor has the ability to affect those returns through its <u>power</u> of 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).

A holding of more than 50% of the voting rights would give the required power (but a holding of less might also give 'de-facto' control, depending on contractual rights).

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

Consolidation

Control requires presentation of consolidated financial statements, unless an exemption applies under para. 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 [para.8-9, App. A IFRS 3]. Net income in the P&L will reflect post-acquisition performance of the subsidiary.

Net Assets

Recognition Principles

Total assets ('A') and liabilities ('L') of the subsidiary acquired (where net assets, 'NA' = A – L) would be recognised at the acquisition date fair values (which may require a formal valuation), whatever the actual percentage holding acquired. On the equity ('E') side of the BS (where E = A – L), the proportion of total NA in which the acquirer does not have an interest (where control was achieved but less than 100% of the ordinary share capital in the target was acquired) is shown as 'Non-Controlling Interests' ('NCI').

A, L, E and net income components are only recognised if (1) they meet the required definition [para. 5.6 IFRS Conceptual Framework 2018] and (2) their recognition provides 'relevant information', which would require judgement, taking into account the degree of uncertainty and probability of inflow or outflow of economic benefits occurring [para. 5.14 IFRS Conceptual Framework 2018].

In general, an asset is defined as a 'present economic resource' (a right that could produce economic benefits) controlled as a result of past events [para. 4.3-4.4 IFRS Conceptual Framework 2018]. Whether it 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 (1) it is <u>probable</u> that future economic benefits associated with it will flow to the company that controls it, and (2) the initial recognition amount can be <u>measured reliably</u> [para.7, 15 IAS 16].

- An intangible asset would be recognised if: (1) the recognition criteria for tangible assets (probability and reliable measurement) are met, (2) it meets the general CF asset definition above, and (3) it is <u>identifiable</u> because (i) it is 'separable' (for example it can be sold) or (ii) it arises from legal rights (for example a registered patent) [para. 8,18, 21 IAS 38].

An intangible asset is recognised in a BC if it meets the definition and recognition criteria. The probability recognition criteria 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 [para. 25,33 IAS 38]. To be recognised in a BC, the intangible would have to pass the intangible definition and be identifiable. If it cannot be recognised, it would simply form part of the consideration that does not relate to identifiable NA (Goodwill) [para.68 IAS 38].

In general, a liability is defined as a 'present obligation', as a result of past events, to transfer an economic resource. 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 [para. 4.26, 4.29, 4.37, 4.43, 4.46 IFRS Conceptual Framework 2018].

Non-contingent and contingent liabilities are treated differently:

- 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 [para.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) <u>or</u> (2) a 'present' obligation (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) [para.10, 14, 17 IAS 37].

  A contingent liability would not be recognised under IAS 37, but be disclosed in the notes to the financial statements. However, 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 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 [para.22-23 IFRS 3].

Measurement Principles

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, and have a 'Carrying Amount' ('CA') on the BS equal to the Initial Amount Recognised ('IAR') less accumulated depreciation ('D') and amortisation ('A'). CA must be reduced to its 'Recoverable Amount' ('RA') due to any value 'Impairment' (with an impairment loss being charged to the P&L). RA is the higher of its 'Fair Value Less Costs to Sell' ('FVLCS')(selling the asset) and its 'Value-In-Use' ('VIU')(using the asset). The FVLCS comprises FV (discussed below) and incremental costs directly attributable to the asset's disposal (ignoring financing costs and tax) [para. 6, 8, 59-61 IAS 36]. In summary: IAR - A - D = CA - Impairment = Impaired CA (higher of: FVLCS,VIU).

FV is a market-based measurement of the 'exit' price to sell an asset or transfer a liability (settlement) in a hypothetical orderly transaction between market participants under market conditions at the measurement date in the principle (or most advantageous) market, irrespective of whether there are observable market transactions and information [para. 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 [para. 3, B2 IFRS 13]. The requirements of IFRS13 apply to BC [para.5 IFRS 13, para.18, App A IFRS 3].

VIU is an asset-based 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 generate 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) 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) [para. 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

[para. 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 [para.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 financing reporting) would differ to 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, which might be set at the level of depreciation. 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' [para.4.35 IFRS Discussion Paper DP/2020/1]

- The discount rate for VIU would be a pre-tax WACC compared to post-tax for DCF.

However, both these restrictions for VIU are the subject of the ***Exposure Draft IASB/ED/2024/1***, and the IASB is proposing to remove them. At the time of writing, a decision is expected in 2026/Q4 (https://www.ifrs.org/projects/work-plan/#ifrs-accounting-projects)

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 [para.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 for a variable monetary amount.

Estimating the fair value of contingent consideration at the date of acquisition would require the use of a valuation technique that reflected assumptions used by market participants to price the liability, most likely the expected PV technique based on probability weighted cash flows (method 2) [Para.14(a), B23 IFRS 13]. The precise method would depend on how the earn-out payoff is determined relative to the performance metric and whether it varies in a linear manner, as described above.

Post-acquisition recognition

Cash consideration paid at the acquisition date and financed with debt will be recognised as a liability initially at fair value and thereafter at its amortised cost, which will not change 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 [para.58 IFRS 3]. Contingent consideration will be recognised post-acquisition according to its initial recognition. Contingent liabilities will be remeasured at each reporting date at fair value, with any change in fair value being recognised in the P&L [para.58 IFRS 3]. The initial goodwill calculation will not be affected.

Goodwill

Initial Recognition

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) [Para.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:

$$\text{Intrinsic Value (i.e. DCF Equity Value)} = \overbrace{NA_{R1} + \overbrace{NA_{R2} + NA_{NR}}^{G}}^{C} + \overbrace{NPV_{G}}^{NPV_{A}\ \text{(NPV for acquirer)}}$$

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 [para.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 [para.51, 52, B50 IFRS 3].

Transaction costs 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, and transaction costs may be eligible to be capitalised as part of the amounts recognised.

Post-acquisition recognition

Goodwill is initially recognised on the BS as an Intangible Asset. During a maximum 12 month 'measurement period' starting at the date of acquisition, the provisional goodwill calculation may be adjusted if new information is obtained about the components in its computation [para.45,46 IFRS 3]. At each reporting date, goodwill is tested for 'impairment', 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 [para. 9,10 IAS 36]. For goodwill, the recoverable amount is based on the 'Cash-Generating Unit' ('CGU') to which the goodwill relates [paras. 66-67 IAS 36] and would need to be estimated at each reporting date. An impairment charge is made to the P&L to reduce the carrying amount to its recoverable amount.

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 [para. 4.3-4.4 IFRS Conceptual Framework 2018]. 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) [para.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 increased 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, such as loans [para.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 [para.32,40 IAS 28].

If a further investment means the investor obtains control, the AM will be required with full consolidation [para.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 [para.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 a status as NCI to 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. [para.23,B96 IFRS 10]

De-Recognition

If a company sells its shareholding with loss of control, under IFRS 3, de-recognition of the consolidated assets, liabilities and NCI at their carrying amounts is required [para.25, B98 IFRS 10]. A profit will arise if the fair value of the consideration received (plus the fair value of any investment retained, if not all the holding is disposed of) exceeds the investor's share of the carrying amount of the net assets of the subsidiary, the carrying amount of goodwill (unimpaired) and the carrying amount of NCI.

Conclusion

An acquisition is not a single event but a sequence of interdependent workstreams: strategic assessment, valuation, due diligence, financing, tax structuring, legal documentation, financial reporting impact, regulatory clearance and post-completion integration. The consideration agreed by purchaser and vendor - the value transferred in exchange for obtaining control of a business - is the product of commercial negotiation, informed by the parties' expectations regarding the future performance of the business, financial and business risks, the availability of financing, prevailing market conditions and their respective bargaining positions. Valuation methodologies provide reasoned estimates of enterprise value based upon available information and professional judgement, but the agreed consideration ultimately reflects the commercial bargain reached between the parties rather than the output of any single valuation model. The form and structure of the consideration, the economic substance of the transaction and legal rights that are created will largely determine how the acquisition is treated in the financial statements of both parties and how the tax impact is determined. Form and structure will also effect how the acquirer will finance the consideration (the subject of a future article).

Suggested reading

Books:

Corporate Finance & Valuation:
Arzac, E.R. (2008) *Valuation for Mergers, Buyouts and Restructurings* (2nd ed.) Wiley.
Damodaran, A. (2025) *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset* (4th ed.) Wiley
Hitchner, J.R (2025) *Financial Valuation: Applications and Models* (5th ed.) Wiley
Holthausen, R.W & Zmijewski, M.E. (2020) *Corporate Valuation: Theory, Evidence & Practice* (2nd ed.). Cambridge.
Pratt, S.P (2022) *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* (6th ed.) McGraw Hill
Trugman, G.R. (2017) *Understanding Business Valuation: A Practical Guide to Valuing Small to Medium Businesses* (5th ed.) Wiley

UK Tax:
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.

IFRS Reporting:
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)
Tan, P., Lim, C.Y., & Kuah, E.W.(2020) *Advanced Financial Accounting: An IFRS® Standards Approach* (4th ed.) McGraw-Hill

APPENDIX 1: Exchange Ratios

In a share-for-share exchange, the Exchange Ratio ('ER') represents the number of shares in the acquirer (S_A) the vendor will receive (VS_A) for each share it holds (VS_T) in the target shares (S_T).

In a private purchase:

$$V_{MS} = V_A + V_T + V_{C+S}$$

Where:

V_{MS}	Equity value of merged entity in a 100% share exchange
V_A	DCF equity value of the acquirer
V_T	DCF equity value of the target
V_{C+S}	Additional value due to control and synergies

A shares / cash consideration mix will reduce the merged value as cash is being paid to the target shareholders:

$$V_{MS/C} = V_{MS} - \text{Cash Consideration}$$

The **maximum** ER ensures all the benefits of the acquisition accrue to the target shareholders. The target shareholders will need a holding in the merged entity that gives them a value equal to their pre-acquisition value plus the value of control and synergies, so that:

$$\frac{VS_A}{S_A + VS_A} \times (V_{MS} - \text{Cash Consideration}) + \text{Cash Consideration} = V_T + V_{C+S}$$

Where:

S_A	Number of acquirer shares before the purchase
VS_A	Number of vendor shares issued in the acquirer $= ER_{MAX} \times VS_T$
VS_T	Number of vendor shares held in the target

After a bit of manipulation, we have:

$$ER_{MAX} = \frac{Y}{1 - Y} \left(\frac{S_A}{VS_T} \right)$$

Where:

$$Y = \boxed{\frac{V_T + V_{C+S} - \text{Cash Consideration}}{V_{MS} - \text{Cash Consideration}}}$$

The maximum ER formula can also be derived from the point of view of the acquirer, where the wealth of the acquirer's shareholders is unchanged. In terms of per share:

$$\textit{Before Acquisition} \qquad\qquad \textit{After Acquisition}$$

$$\frac{\text{Acquirer Value}}{\text{Acquirer Shares}} = \frac{\text{Merged Value}}{\text{Acquirer Shares} + \text{Shares Issued to Vendor}}$$

$$\frac{V_A}{S_A} = \frac{V_{MS} - \text{Cash Consideration}}{S_A + VS_T \times ER_{MAX}}$$

$$ER_{MAX} = \frac{V_{MS} - \text{Cash Consideration} - V_A}{V_{A\text{ per acquirer share}} \times S_T}$$

$$= \frac{(V_T + V_{C+S} - \text{Cash Consideration})_{\text{per target share}}}{\text{Acquirer Price}}$$

The **minimum** ER ensures all the benefits of the acquisition accrue to the acquirer shareholders, so that the target shareholders have exactly the same value as before the purchase. This is the same as for the maximum ER formula except the term V_{C+S} is ignored.

$$\frac{VS_A}{S_A + VS_A} \times (V_{MS} - \text{Cash Consideration}) + \text{Cash Consideration} = V_T$$

So that:

$$ER_{MIN} = \frac{Z}{1 - Z}\left(\frac{S_A}{S_T}\right)$$

Where:

$$Z = \boxed{\frac{V_T - \text{Cash Consideration}}{V_{MS} - \text{Cash Consideration}}}$$

This can be written as follows for 100% shares [see p.700-701 Holthausen & Zmijewski]:

$$ER_{MIN(100\%\text{ shares})} = \frac{V_{T\text{ per target share}} \times S_A}{V_M - V_T}$$

$$= \frac{V_{T\text{ per target share}}}{(V_A + V_{C+S})_{\text{per acquirer share}}}$$

When adjusing for cash consideration this becomes:

$$ER_{MIN(cash/shares)} = \frac{(V_T - \text{Cash Consideration})_{\text{per target share}}}{(V_A + V_{C+S})_{\text{per acquirer share}}}$$

To share the benefits, the ER would be set as follows:

$$ER_{OFFER} = \frac{\text{Offer Price} - (\text{Cash Consideration} / S_T)}{\text{Acquirer Price}}$$

This can be illustrated in a simple example:

Example 1: 100% shares

Acquirer (value £250m) values Target at £90m (including £10m synergies value), giving a merged value of £340m. It offers £38.00 for 100% of Target's 2m shares (consideration £76m, NPV £14m). Target and Acquirer's stand alone DCF equity values per share (minority / marketable, so equivalent to a quoted share price) are £32.00 and £20.00, respectively. An ER of 1.90 is offered, set as offer price / Acquirer price (£38.00 / £20.00). Target shareholders receive 3.8m shares in Acquirer (1.9 x 2m Target shares), giving a 23.3% holding (3.8m / [12.5m + 3.8m]). The merged price per share is £20.86 (£340m / 16.3m). The value to the vendor is in two parts: the purchase price (£76m) less their pre-acquisition holding value (£64m) = £12m + share of Acquirer NPV (23.3% x £14m = £3.264m, giving total value change of £15.264m).

All figures in '000s unless otherwise stated

ASSUMPTIONS

			Target		Acquirer	Merged
			Total	Per Share		
Shares outstanding		No.	2,000		12,500	
DCF Equity Value per share (minority, marketable)		£			20.00	
Equity Value (minority, marketable)		£	64,000	32.00		
Control premium (marketable)	25.00%	£	16,000			
Control Value			80,000			
Synergies		£	10,000			
Value to Acquirer		£	90,000		250,000	340,000
Without synergies		£		8.00		
Synergies		£		5.00		
Value to Acquirer per share		£		45.00		
Transaction costs	0.00%	£				
Acquisition cost		£	76,000	38.00		
Cash	0.00%		-	-		-
Shares	100.00%		*76,000*	*38.00*		
Acquirer NPV / Value		£	14,000	7.00		340,000

Value 'stack':			
Equity Value (minority, marketable)		64,000	Minimum price for Vendor
Control premium - paid for	12,000	12,000	Vendor NPV
Purchase price		76,000	
Control premium- not paid for	4,000	4,000	Acquirer NPV (£14.0m)
Synergies - not paid for	10,000	10,000	
Acquirer - Target Value	26,000	90,000	
Acquirer Value		250,000	
Combined value		340,000	

100.0% SHARES : 0.0% CASH

			Shareholding		Value			
			Shares	Holding	Pre-Acq	Post-Acq	Cash	Change
			No.	%	£	£		£
Acquirer			12,500	76.7 %	250,000	260,736		10,736
Target shareholders			3,800	23.3 %	64,000	79,264	-	15,264
Merged - post acquisition	£	20.86 price	16,300	100.0 %		340,000		26,000

		Per Target Share		Vendor Value		Value Change
Pre-acquisition		32.00	£	64,000	Share of Acquirer NPV - Acquirer	10,736
Vendor NPV		6.00	£	12,000	Share of Acquirer NPV - Vendor	3,264
Acquisition cost		38.00	£	76,000	Acquirer NPV	14,000
Share of Acquirer NPV		1.63	£	3,264	Target NPV - Cash	12,000
Cash component			£	-		
Value of shares			£	79,264		
Value of cash			£	-	Value of cash	-
Value for Target shareholders	£	39.63 /share	£	79,264	Total change	26,000

FINAL x 1.900 x 2,000 shares = 3,800 shares

FINAL EXCHANGE RATIO

$$\frac{\text{Offer Price in Shares}}{\text{Acquirer price}} = \frac{38.00}{20.00}$$

x 1.900

Min ER for Target shareholders: NPV → Acquirer Shareholders

100.0% SHARES : 0.0% CASH

			Shareholding		Value			
			Shares	Holding	Pre-Acq	Post-Acq	Cash	Change
			No.	%	£	£		£
Acquirer			12,500	81.2 %	250,000	276,000		26,000
Target shareholders			2,899	18.8 %	64,000	64,000	-	-
Merged - post acquisition	£	22.08 price	15,399	100.0 %		340,000		26,000

		Per Target Share		Vendor Value		Value Change
Pre-acquisition		32.00	£	64,000	Share of Acquirer NPV - Acquirer	26,000
Vendor NPV		6.00	£	12,000	Share of Acquirer NPV - Vendor	(12,000)
Acquisition cost		38.00	£	76,000	Acquirer NPV	14,000
Share of Acquirer NPV		(6.00)	£	(12,000)	Target NPV - Cash	12,000
Cash component			£	-		
Value of shares			£	64,000		
Value of cash			£	-	Value of cash	-
Value for Target shareholders	£	32.00 /share	£	64,000	Total change	26,000

MIN x 1.449 x 2,000 shares = 2,899 shares

MINIMUM EXCHANGE RATIO

$$\frac{V_T \ - \ \text{Cash Consideration}}{V_M \ - \ \text{Cash Consideration}} = \frac{64{,}000 \ - \ -}{340{,}000 \ - \ -} = \frac{64{,}000}{340{,}000} \quad 0.1882 \quad = Z$$

$$\frac{\text{Acquirer Shares}}{\text{Target Shares}} \times \frac{Z}{1 - Z} = \text{x } 1.449$$

Min Formula 1 Formula 1

$$\frac{(V_T \ - \ \text{Cash Consideration}) \ / \ \text{Target shares}}{(V_A \ + \ V_{C+S}) \ / \ \text{Acquirer shares}} \quad \frac{(64{,}000 \ - \ 0) \ / \ 2{,}000}{(250{,}000 \ + \ 26{,}000) \ / \ 12{,}500} \quad \frac{32.00}{22.08} = \text{x } 1.449$$

Min Formula 2

Max ER for Acquirer shareholders: NPV → Target Shareholders

100.0% SHARES : 0.0% CASH

		Shareholding		Value			
		Shares	Holding	Pre-Acq	Post-Acq	Cash	Change
		No.	%	£	£		£
Acquirer		12,500	73.5 %	250,000	250,000		-
Target shareholders		4,500	26.5 %	64,000	90,000	-	26,000
Merged - post acquisition	£ 20.00 price	17,000	100.0 %		340,000		26,000

	Per Target Share		Vendor Value		Value Change
Pre-acquisition	32.00	£	64,000	Share of Acquirer NPV - Acquirer	-
Vendor NPV	6.00	£	12,000	Share of Acquirer NPV - Vendor	14,000
Acquisition cost	38.00	£	76,000	Acquirer NPV	14,000
Share of Acquirer NPV	7.00	£	14,000	Target NPV - Cash	12,000
Cash component		£	-		
Value of shares		£	90,000		
Value of cash		£	-	Value of cash	-
Value for Target shareholders	£ 45.00 /share	£	90,000	Total change	26,000

MAX x 2.250 x 2,000 shares = 4,500 shares

MAXIMUM EXCHANGE RATIO

$$\frac{V_T + V_{C+S} - \text{Cash Consideration}}{VM - \text{Cash Consideration}} = \frac{64{,}000 + 26{,}000 - \quad -}{340{,}000 \quad - \quad -} = \frac{90{,}000}{340{,}000} \quad 0.2647 = Y$$

$$\frac{\text{Acquirer Shares}}{\text{Target Shares}} \times \frac{Y}{1 - Y} = \text{x } 2.250$$

Max Formula 1

$$\frac{(V_T + V_{C+S} - \text{Cash Consideration}) / \text{Target shares}}{\text{Acquirer Price}} = \frac{45.00}{20.00} = \text{x } 2.250$$

Max Formula 2

Example 2: 75% shares:25% Cash

If cash is offered, the ER formulae need to be adjusted to reflect only the share component. The value of the merged entity is reduced by the cash element; Target shareholders' value change will be both in respect of shares and cash.

All figures in '000s unless otherwise stated

ASSUMPTIONS

			Target		Acquirer	Merged
			Total	Per Share		
Shares outstanding		No.	2,000		12,500	
DCF Equity Value per share (minority, marketable)		£			20.00	
Equity Value (minority, marketable)		£	64,000	32.00		
Control premium (marketable)	25.00%	£	16,000			
Control Value			80,000			
Synergies		£	10,000			
Value to Acquirer		£	90,000		250,000	340,000
Without synergies		£		8.00		
Synergies		£		5.00		
Value to Acquirer per share		£		45.00		
Transaction costs	0.00%	£				
Acquisition cost		£	76,000	38.00		
Cash	25.00%		*19,000*	*9.50*		(19,000)
Shares	75.00%		*57,000*	*28.50*		
Acquirer NPV / Value		£	14,000	7.00		321,000

75.0% SHARES : 25.0% CASH

		Shareholding		Value			
		Shares	Holding	Pre-Acq	Post-Acq	Cash	Change
		No.	%	£	£		£
Acquirer		12,500	81.4 %	250,000	261,401		11,401
Target shareholders		2,850	18.6 %	64,000	59,599	19,000	14,599
Merged - post acquisition	£ 20.91 price	15,350	100.0 %		321,000		26,000

	Per Target Share		Vendor Value		Value Change
Pre-acquisition	32.00	£	64,000	Share of Acquirer NPV - Acquirer	11,401
Vendor NPV	6.00	£	12,000	Share of Acquirer NPV - Vendor	2,599
Acquisition cost	38.00	£	76,000	Acquirer NPV	14,000
Share of Acquirer NPV	1.30	£	2,599	Target NPV - Cash	(7,000)
Cash component		£	(19,000)		
Value of shares		£	59,599		
Value of cash		£	19,000	Value of cash	19,000
Value for Target shareholders	£ 39.30 /share	£	78,599	Total change	26,000
FINAL			**x 1.425**	x 2,000 shares = 2,850 shares	

The value for Target shareholders (£78,599) is less than for the 100% share case (£79,264). If the NPV was zero, this difference would not arise because the reduction in value from the cash payment (£19m / (£340m - £14m NPV) = 5.83%) would be matched by the reduction in shares due to the exchange ratio falling as a result of the cash component being stripped out (target shares 2m x offer price in cash £9.50 / acquirer price £20 = 0.95m / 16.3m all share offer = 5.83%). In this scenario, the merged share price would be the same as Acquirer's pre-acquisition price (£20.00 = £307m merged value / 15.35m merged shares = [£340m - £14m NPV - £19m cash] / [shares for all share 16.3m – 0.95m share reduction]).

The min and max ERs are calculated as before, but ignoring the cash component:

75.0% SHARES : 25.0% CASH

		Shareholding		Value			
		Shares	Holding	Pre-Acq	Post-Acq	Cash	Change
		No.	%	£	£		£
Acquirer		12,500	86.0 %	250,000	276,000		26,000
Target shareholders		2,038	14.0 %	64,000	45,000	19,000	-
Merged - post acquisition	£ 22.08 price	14,538	100.0 %		321,000		26,000

	Per Target Share		Vendor Value		Value Change
Pre-acquisition	32.00	£	64,000	Share of Acquirer NPV - Acquirer	26,000
Vendor NPV	6.00	£	12,000	Share of Acquirer NPV - Vendor	(12,000)
Acquisition cost	38.00	£	76,000	Acquirer NPV	14,000
Share of Acquirer NPV	(6.00)	£	(12,000)	Target NPV - Cash	(7,000)
Cash component		£	(19,000)		
Value of shares		£	45,000		
Value of cash		£	19,000	Value of cash	19,000
Value for Target shareholders	£ 32.00 /share	£	64,000	Total change	26,000
MIN			**x 1.019**	x 2,000 shares = 2,038 shares	

MINIMUM EXCHANGE RATIO

$$\frac{V_T - \text{Cash Consideration}}{V_M - \text{Cash Consideration}} = \frac{64{,}000 - 19{,}000}{340{,}000 - 19{,}000} = \frac{45{,}000}{321{,}000} \quad 0.1402 = Z$$

$$\frac{\text{Acquirer Shares}}{\text{Target Shares}} \times \frac{Z}{1 - Z} = \text{x } 1.019$$

Min Formula 1   Formula 1

$$\frac{(V_T - \text{Cash Consideration}) / \text{Target shares}}{(V_A + V_{C+S}) / \text{Acquirer shares}} = \frac{(64{,}000 - 19{,}000) / 2{,}000}{(250{,}000 + 26{,}000) / 12{,}500} = \frac{22.50}{22.08} = \text{x } 1.019$$

Min Formula 2

75.0% SHARES : 25.0% CASH

			Shareholding		Value			
			Shares	Holding	Pre-Acq	Post-Acq	Cash	Change
			No.	%	£	£		£
Acquirer			12,500	77.9 %	250,000	250,000		-
Target shareholders			3,550	22.1 %	64,000	71,000	19,000	26,000
Merged - post acquisition	£	20.00 price	16,050	100.0 %		321,000		26,000

		Per Target Share		Vendor Value		Value Change
Pre-acquisition		32.00	£	64,000	Share of Acquirer NPV - Acquirer	-
Vendor NPV		6.00	£	12,000	Share of Acquirer NPV - Vendor	14,000
Acquisition cost		38.00	£	76,000	Acquirer NPV	14,000
Share of Acquirer NPV		7.00	£	14,000	Target NPV - Cash	(7,000)
Cash component			£	(19,000)		
Value of shares			£	71,000		
Value of cash			£	19,000	Value of cash	19,000
Value for Target shareholders	£	45.00 /share	£	90,000	Total change	26,000

MAX x 1.775 x 2,000 shares = 3,550 shares

MAXIMUM EXCHANGE RATIO

$$\frac{V_T + V_{C+S} - \text{Cash Consideration}}{VM - \text{Cash Consideration}} = \frac{64{,}000 + 26{,}000 - 19{,}000}{340{,}000 - 19{,}000} = \frac{71{,}000}{321{,}000} \quad 0.2212 = Y$$

$$\frac{\text{Acquirer Shares}}{\text{Target Shares}} \times \frac{Y}{1 - Y} = \text{x } 1.775$$

Max Formula 1

$$\frac{(V_T + V_{C+S} - \text{Cash Consideration}) / \text{Target shares}}{\text{Acquirer Price}} = \frac{35.50}{20.00} = \text{x } 1.775$$

Max Formula 2

APPENDIX 2: Examples – Taxation Of Shares & Securities – Exchanges, Conversions, Earnouts

Example 1: 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 on exchange £151m). Vendor exchanged these shares and securities in return for cash (20%), shares (50%), QCBs (15%) and non-QCBs (15%) with an equivalent total value: cash £30.2m, Shares £75.5m, QCBs £22.65m and non-QCBs £22.65m. Acquirer's post-exchange holding was 70%, meaning s135 TCGA 1992 applied.

At the date of exchange, Acquirer's equity value was agreed at £375m, so a £75.5m value required the issue of 37.813m new Acquirer shares (pre-issue shares 150m) to give Vendor its required 20.133% holding (20.133% x £375m = £75.5m).

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. In addition to 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 (33.5% of proceeds).

If the Vendor had instead received 100% of its £151m value at exchange in the form of shares in Acquirer (which grew 46.7% in equity value - adjusting for the QCBs and non-QCBs that would not be issued – from exchange to disposal) total disposal proceeds would have been £221.467m (vs. £180.867m for the agreed mix) and gains £106.467m (48.1% of proceeds).

Numbers in '000 unless stated otherwise

GAIN AT DATE OF EXCHANGE

			Target				Acquirer			
At Exchange			Vendor	Other	Acquirer	Total	Vendor	Other	Acquirer	Total
Purchase - Ordinary Shares	30/06/20	£	30,000							
Purchase - QCBs	"	£	50,000							
Purchase - Non-QCBs	"	£	35,000							
Exchange - Ordinary Shares	30/06/25	No	30,000	15,000	5,000	50,000	-	150,000		150,000
Exchange - Shareholding	"	%	60.0 %	30.0 %	10.0 %	100.0 %	-	100.0 %	-	100.0 %
Exchange - Shares Value	"	£	60,000	30,000	10,000	100,000	-	375,000	-	375,000
Exchange - QCB Value	"	£	53,000							
Exchange - Non-QCB Value	"	£	38,000							
After Exchange										
Disposal - Shares Value	30/06/26	£								500,000
Disposal - QCB Value	"	£								25,000
Disposal - Non-QCB Value	"	£								25,000

		In Target		Allocate Value in Acquirer				
Allocate Value at Exchange		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				20.0 %	50.0 %	15.0 %	15.0 %	100.0 %

		Target				Acquirer			
Allocate Shareholdings at Exchange		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	%	60.0 %	30.0 %	10.0 %	100.0 %	-	100.0 %	-	100.0 %
Post-Exchange Holding	%	-	30.0 %	**70.0 %**	100.0 %	20.1 %	79.9 %	-	100.0 %
Value requirement	%/£	20.1 %				75,500			375,000

			In Target		Allocate Base Cost in Acquirer				
Allocate Cost at Exchange			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

			In Target		Gain on Exchange of Target Instruments				
Calculate Gain at Exchange			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

The green shaded cells represent: shares or non-QCBs held in Target that are exchanged for shares or non-QCBs in the Acquirer. These would be treated under the s127 reorganisation rules as the s135 relief applies. No gain would be calculated since no disposal is deemed to have arisen: the final sale of the shares or non-QCBs in Acquirer would be calculated using the base cost of the shares or non-QCBs (as allocated) in Target. The gains are shown here for illustrative purposes.

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

Note:

(1) Shares and non-QCBs are treated the same: capital distribution if cash is received, no disposal if shares or non-QCBs are received, gain 'frozen' if QCBs received and crystalised when the QCBs are sold.

(2) QCBs are exempt but are shown here for illustrative purposes.

GAIN AT DATE OF FINAL DISPOSAL

				In Acquirer			
			Cash	Shares	QCBs	Non-QCBs	Total
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 orginally 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 orginally 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 orginally 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 orginally 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 orginally 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 gain			6,600	41,667	4,950	7,300	60,517
Gain as % of Disposal			21.9 %	41.4 %	19.8 %	29.2 %	33.5 %
Taxed on Exchange	30/06/25	£	6,600				
Taxed on Disposal	30/06/26	£		41,667	4,950	7,300	

Reconciliation to 100% share scenario				In Acquirer			
Proceeds:			Cash	Shares	QCBs	Non-QCBs	*Total*
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		£	14,093	35,233	10,570	10,570	70,467
Proceeds if 100% shares		£	44,293	110,733	33,220	33,220	221,467
Gains:							
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		£	21,293	11,567	15,970	15,970	64,800
Gain if 100% shares issued		£	21,293	53,233	15,970	15,970	106,467
Shares issued if 100% shares issued:							
Exchange Value		£	30,200	75,500	22,650	22,650	151,000
Holding in Acquirer (Value £375.0m)		%	8.1 %	20.1 %	6.0 %	6.0 %	40.3 %
Required Shares		No.	13,138	37,813	9,642	9,642	70,236
Disposal value (£550.0m *)	+ 46.7 %	£	44,293	110,733	33,220	33,220	221,467
Base cost		£	(23,000)	(57,500)	(17,250)	(17,250)	(115,000)
Gain - assuming shares issued and not cash, QCBs or non-Q(			21,293	53,233	15,970	15,970	106,467
Gain as % of Disposal			48.1 %	48.1 %	48.1 %	48.1 %	48.1 %

* If the QCBs and non-QCBs are not issued, their market value should be added back to the Target equity value whch assumes they have been issued

Example 2: Deferred Consideration: Ascertainable & Unascertainable (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 x £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 (x1.0, x1.2 and x1.3, 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 The tax authority expects EBITDA (probability weighted) to be £100m, £120m and £130m in T_1,T_2 and T_3 respectively, based on its own assumptions, giving expected earn-out payments of £100m, £144m and £169m. The expected 3 payments discounted at 10% (assumed for this example) back to T_0 give a present value of £336.89m. This amount is added to the upfront £300m consideration to produce a gain of £586.89m.

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 x 1.2). The estimate for EBITDA for T_3 remains at £125m, giving an expected £162.5m payout, valued at £147.7m (= £125m x 1.3 = £162.5m / 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 initial value – £nil allocated to T_1) x £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 initial value - £nil allocated to T_1 - £164.9m allocated to T_2]).

The total gain under scenario 2 = T_0 gain £586.89m + T_1 gain (£Nil) + T_2 gain (- £23.3m loss) + T_3 gain (-£5.6m loss = £558m. This will always be equal to actual cash received – base cost (= £300m up front + T_2 payment £141.6m + T_3 payment £166.4m - £50m cost = £558m).

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.

All figures in millions

			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	Actual
				10.0 % Discount rate			EBITDA	Earn-out
	At T0	At T1	At T2	At T0	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

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