

# Corporate Finance Update

Issue 12 – Summer 2008

The budget – taper relief & the new tax year

Effects of the market on corporate finance – the credit crunch

Calling recommendations for CF – plan, restructure or sale?

Chartered Developments

**Corporate Finance**

Centre of Excellence

## The new tax year

CF providers and businesses will have had a busy time during the run-up to the end of the tax year deadline April 5th. The driving force behind this activity is the deft change to CGT by the withdrawal of taper relief. Moving on into the new tax year there will still be a need for CF and to recognise how the changes may effect decision making for transactions requiring CF Advisory.

•Headline rate (The rate of inflation unadjusted for one-off, abnormal or distorting factors) of corporation tax is 28% from April 2008.

### Change in corporate tax rate – deferred tax implications

The fall in the rate of UK mainstream corporation tax in April 2008 from 30% to 28% was reaffirmed. The new 28% rate will continue to be effective from 1 April 2009. As this change was enacted in Finance Act 2007, companies should adjust the effective rate when calculating their deferred tax going forward.

**Changes to small companies' corporate tax rate** - Small companies' rate of CT increases from 20% to 21% from April 2008.

The small companies' rate will become 21% (up from 20%) from 1 April 2008 and the fraction used in smoothing the difference between this and the main corporate rate (marginal small companies' relief) will be 7/400. Profit limits will remain the same.

To ensure that the changes to the R&D tax relief announced in Budget 2007 receive EU State Aid approval:

companies will not be entitled to relief where their most recent accounts are not on a going concern basis;

and

relief under the SME regime will be restricted to €7.5m per project.

From April 2008, businesses will be able to write off the remaining balance in both the general capital allowance pool and the 10% pool when it falls below £1,000.

From April 2008 the associated companies rules for the small companies rate of corporation tax are to lessen the importance of the attribution of powers to company associates.

## Transfers of partnership interests

Finance Act 2007 materially extended the scope of the provision that charges SDLT (Stamp Duty Land Tax) on transfers of interests in partnerships. The impetus was perceived avoidance. Unfortunately, the changes had a significant effect on the **commercial property market**. Also introduced is the concept of an election under which a person can ensure full SDLT is paid on a transfer to a partnership so that all future type B transfers of interests in the partnership would be exempt from SDLT.

From Budget day, businesses acquiring, disposing or appropriating trading stock other than in the course of trade will be required to use market value in calculating taxable profits. This is already in place.

“On the whole, UK companies will not be pleased with the substance of today's Budget. Today's new measures, combined with changes announced in last year's Budget, mean that businesses will pay an extra £2 billion a year in tax from April. After last year's Budget, businesses were facing an additional £1.4 billion tax bill following changes to capital allowances. Now, the Government wants a further £600 million from them.

“There will be a welcome for increases in Enterprise Investment Scheme and Enterprise Management Incentive (share options for small, start-up companies, often in the technology sector) limits to £500,000 pa and £120,000 respectively, though EMI schemes are now limited to enterprises of less than 250 employees.

“The transition to 18% flat rate capital gains tax following abolition of business asset taper relief has, as expected been softened for many taxpayers by the introduction of the Entrepreneurs relief, apparently expected to benefit about 80,000 taxpayers. The introduction of the £50,000 automatic first year allowance for capital expenditure (excluding cars, but including long life assets) will be a helpful simplification for many small businesses.”

## 'Credit Crunch' – a brief economic backdrop

The dominant economic effect of the looming credit crunch has impacted on the planning for the UK budget and more specifically on the availability of corporate finance lending from Banks. Although the problem originated with Homebuyer mortgages in the US, the US sub-prime mortgage crisis has adversely affected worldwide confidence in investments and loan security.

Mortgage interest rates are based on the LIBOR (London InterBank Offered Rate - the rate which banks are prepared to lend to one other), this has increased dramatically as a consequence of increased risks. The recent trouble with Northern Rock is a clear example of this.

Major Banks have been affected by the sub-prime credit losses:

**Citigroup: \$18bn**  
**Merrill Lynch: \$14.1bn**  
**UBS: \$13.5bn**  
**Morgan Stanley \$9.4bn**  
**HSBC: \$3.4bn**  
**Bear Stearns: \$3.2bn**  
**Deutsche Bank: \$3.2bn**  
**Bank of America: \$3bn**  
**Barclays: \$2.6bn**  
**Royal Bank of Scotland: \$2.6bn**  
**Freddie Mac: \$2bn**  
**JP Morgan Chase: \$3.2bn**  
**Credit Suisse: \$1bn**  
**Wachovia: \$1.1bn**  
**IKB: \$2.6bn**  
**Paribas: \$197m**

Details from company records

This means that debt (loan finance) is more expensive to obtain across all sectors.

For much the same reason Private Equity has also taken a downturn:

The Centre for Management Buy-out Research reported that in the last quarter of 2007 the UK Private Equity market dropped by 80%, from \$15.4bn in Q3 down to £2.9bn. source-CMBOR

"There has been a lot of leveraged buyouts in the US helping push up the value of equities, financed by debt and underwritten by American and European banks.

The way this works, is that the banks will initially provide a bridging loan type of financing, but then ultimately look to syndicate the debt away to other banks or hedge funds.

The problem now is that the buyer base is more uncertain amid all the problems." **BARNABY MARTIN, MERRILL LYNCH – source BBC**

## How to ease the promotion CF services during the current economic climate - Calling approaches

With the shortage of cheap debt or low cost finance many companies will be reluctant to actively seek acquisitions unless necessary. The economic pressure put upon businesses and consequently lenders (Banks being the predominant source of finance) across the country is the root of what is now been dubbed a credit crunch by the UK media. The US is also suffering a similar downturn that is teetering on the brink of a full 'recession'

The British Chambers of Commerce, in its new economic forecast, warns that growth will slow to 1.7% this year from 3.1% in 2007, despite interest-rate cuts. It expects Bank rate to be reduced to 4.75% by the middle of the year.

During this period there will be many necessary cut-backs, redundancies, forced liquidation and insolvency cases.

Figures generated by the Chartered Institute of Personnel and Development in conjunction with KPMG, are set to show that 38% of the more than 1,500 employers surveyed plan redundancies over the next three months, with a quarter intending to let go at least 10 employees. This latest figure is sharply up on the 17% of three months ago. Source-The Sunday Times

A potentially successful route for calling on CF is to promote restructuring possibilities and the related services:  
refinancing, strategic planning, exit/succession or recovery planning,  
financial risk management (due diligence), de-listing

SMEs and OMBs may need assistance raising finance and to strategise for redundancies, pension buy-outs, trade mergers for stability, contracts of sale for a reduction in size i.e sale of premises and to lower running costs.

Medium to large companies will weather-it-out and some will be looking to take advantage of any opportunities for low price purchases offered by struggling businesses, or even to upwardly galvanise by joining with a larger company.

