NELLEN NEWS

Spring 2011

CONTENTS

Enterprise Investment Schemes:
- Boost for Investors and Companies

Recent Transactions

Enhanced consideration for Shares
- Grays Timber Products Limited v HMRC

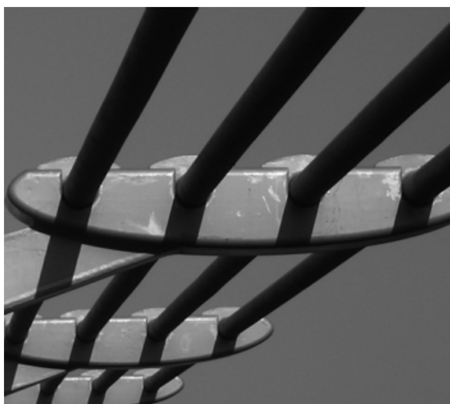
Where has Authorised Share Capital gone?

Client Profile
- Global Healthcare Exchange

Enterprise Management Schemes:
- "Permanent establishment"

Removal of Default Retirement Age on 6 April 2011

19 Albemarle Street
London W1S 4HS
T: +44 (0)20 7499 8122
F: +44 (0)20 7493 0146
E: info@nellen.co.uk
www.nellen.co.uk



EIS: Boost for Investors and Companies

Investors and SME's were favoured by planned changes announced in the March 2011 budget to Enterprise Investment Schemes (EIS), which offer income and capital gains tax relief to investors in small and medium sized companies.

With effect from 6 April 2011, the rate of income tax relief given under EIS will rise from 20% to 30% while the amount of investment an individual can invest through EIS in any one tax year that can attract up front tax relief will double from 6 April 2012 to £1m.

From 6 April 2012 more companies will be eligible to attract investment through EIS as investors will be permitted to invest in companies with up to 250 employees (current level is 50) and with gross assets before the investment of no more than £15m, up from £7m. There will also be an increase in the annual amount that any single company or group can receive under EIS from £2m to £10m.

This is all part of the government policy to make it easier and more attractive to finance and grow small and medium sized companies.

(continued on back page)

Recent Transactions

A selection of recent transactions on which **NELLEN** has advised:

- Californian based publisher **Chronicle Books LLC** and New York based publisher **Harry N Abrams, Inc** on the establishment of a UK joint venture marketing and distribution company to serve the EMEA markets.
- **GHX UK Limited** on the UK aspects of the refinancing of its parent company credit facility provided by General Electric Capital Corporation.
- **Flacq Architects Limited,** the London based practice, on its sale to Arup Associates.
- **Euroslot SA,** a world leader in the design and manufacture of reactor internals, on the purchase of Staffordshire based KDSS Limited, a company providing mass transfer products and related services to the oil refining and petrochemical industries.
- **Lulu Guinness Holdings Limited** on the investment by Hong Kong based fund FE Partners (Europe) Limited.
- **Haberman Associates,** the inventor of the patented Anywayup Cup and other baby products, on a new company created to exploit its intellectual property and develop related products.
- **International Asset Management Limited,** a fund of hedge funds investment manager, on the introduction of an Enterprise Management Incentive Scheme.

Enhanced consideration for Shares

Companies seeking to recruit senior executives often offer them the opportunity of subscribing for new shares at the time of joining. Occasionally attempts are made to provide a key executive with an additional incentive on a sale of the company if the exit price exceeds pre-agreed targets. If structured incorrectly the incentive element can attract income tax and National Insurance Contributions (NIC).

Such an arrangement was considered by the Supreme Court in 2010 in *Grays Timber Products Limited v HMRC* where it was held that the managing director of Grays Timber Products Limited (Grays), Mr Gibson, had received consideration on the sale of his shares that exceeded their market value. As a result the excess was taxable as employment income and subject to income tax and NIC under the provisions of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003).

The facts were as follows. At the time Mr Gibson joined Grays as managing director he signed a subscription agreement under which he paid £50,000 to take up 6% of the ordinary share capital.

The agreement included a provision under which, if a sale of the company took place more than 2 years after Mr Gibson had joined, he would be entitled to his original £50,000 plus one third of the sale price above the target net asset value of the group at the date of sale.

Just over two years into his service agreement Grays was sold for £6m. As a result of the formula Mr Gibson received £1.45m or just under 25% of the total consideration for the sale of his 6% stake. HMRC argued that the amount Mr Gibson received exceeded the market value of his shares by over £1m.

The main area of controversy was the meaning of "market value". This is defined in ITEPA 2003 by reference to the capital gains tax legislation ie the price which an asset might reasonably be expected to fetch on a sale in the open market.

Mr Gibson’s case was that the asset to be valued, namely the shares, merely fetched their market value because the share rights comprised not only their intrinsic rights set out in the Articles but also their enhanced extrinsic rights contained in the subscription agreement.

The Supreme Court rejected the argument agreeing with HMRC that the market value of Mr Gibson's shares must be based solely on the share rights set out in the Articles and that therefore Mr Gibson had received on the disposal of his shares a consideration which exceeded their market value. This excess was subject to income tax and NIC.

Where has Authorised Share Capital gone?

Prior to the Companies Act 2006 companies were required to have an authorised share capital (eg £100,000) divided into shares of a nominal amount (eg £1). This authorised share capital could of course be increased by ordinary resolution so when making new issues of shares it was often necessary to include a resolution increasing the authorised share capital.

Companies therefore often incorporated with a substantial authorised share capital to allow headroom to issue further shares without the need to increase the authorised share capital. A company's authorised share capital conveyed no sense of its shareholders' funds and some even argued it could be misleading especially in foreign jurisdictions.

In the light of this the 2006 Act, with effect from October 2009, abolished the requirement for a company to have an authorised share capital. All that is required on incorporation is a memorandum stating the number of shares subscribed and their nominal value. When further shares are allotted, a form filed at Companies House updates the issued share capital.

However, as existing companies had set levels of authorised share capital, transitional provisions provide that these will be deemed to be incorporated in the company's Articles and would operate as a restriction on the number of shares that a company can issue. Unusually, although such a provision is deemed to be part of the Articles, it can be amended or revoked by ordinary resolution. An express authority to issue shares in excess of the limit is deemed to have the same effect.

Newly formed companies wanting to limit the number of shares that the directors can issue without a shareholders' resolution could still include a restriction in its Articles on the number of issued shares or limit the directors' authority.

Client Profile: Global Healthcare Exchange

One of the major challenges facing the healthcare industry is to improve the process by which thousands of customers and suppliers source, procure, buy and pay for the myriads of products available.

The inefficiencies that result from inaccurate product data, delayed fulfilment or incorrect invoicing, for example, results in billions of pounds of unnecessary staff costs spent researching these issues and the associated lost opportunity costs for both customers and suppliers.

Global Healthcare Exchange, LLC (GHX) was formed in 2000 by some of the world's largest medical products manufacturers including Johnson & Johnson and GE Healthcare to address these problems. Leading the way in the early business to business exchange market, GHX focused on building a robust, reliable electronic trading exchange designed for health service suppliers, providers and manufacturers to do business buying and selling supplies online with multiple trading partners via a single connection.

GHX is now owned by 20 shareholders from across the spectrum of the healthcare supply chain, including manufacturers, distributors, hospitals and group purchasing organisations. Today 95% of US medical products are transacted through the GHX exchange.

GHX Europe

GHX Europe GmbH currently operates in a number of European countries and is the leading platform enabling hospitals and suppliers to conduct business through a single exchange.

GHX UK Limited (GHX UK), formerly TecSol Limited (a software development house which developed solutions for the NHS), was acquired by GHX Europe GmbH in two stages, the final stage taking place in 2006. GHX UK has more than 500 connections to buying organisations such as NHS Trusts and Primary Care Trusts which are able to transact business with more than 800 selling organisations from the largest multinationals to SMEs.

As a business hub for healthcare, by automating the purchasing process, GHX UK enables healthcare providers to reduce operating and labour costs and improve operational performance and margins. The UK has seen strong growth as more and more purchasers and suppliers join the network.

Products and their benefits

The GHX solutions have been developed in-house and new products are continually being added to the portfolio to support as many systems that typically exist within a healthcare provider's organization. There might, for example, be one system in a hospital for inventory management and another for financial management. GHX's aim is to be able to glue the various systems together.

Automation of the ordering process, including delivery of invoices, improves the accuracy of the ordering process resulting in fewer returned goods, fewer expedited shipments and fewer credit notes.

Some of the most common, costly and time-consuming challenges facing the health service supply chain arise from the lack of accurate product data and data synchronization between buyers and sellers. GHX products help health service buyers and sellers to maintain and continually improve their product data by providing sophisticated catalogue, pricing and contract management services.

This gives the hospital pharmacy reassurance that when it places an order the product code and current price will be accurate and that its order will be efficiently routed to the supplier.

The future for GHX

At a time when budgets are being cut by most western governments, the spotlight is on streamlining healthcare costs. GHX is continuing to work on new products to create more cost savings that will improve the healthcare supply chain process.

NELLEN advised GHX Europe GmbH on its two stage purchase of GHX UK Limited and advised on the UK aspects of the recent refinancing of its parent company credit facility provided by General Electric Capital Corporation.

EIS: Boost for Investors and Companies (continued from front page)

Plans to consult on simplifying the EIS rules, for example removing restrictions on qualifying shares and types of investor, were also announced providing further encouragement for investors albeit tempered by the government's hint that it intends to refocus EIS to ensure that they are targeted at 'genuine risk capital investments'. All of the changes are subject to EU State aid approval.

EIS will become significantly more attractive to private investors as the tax relief on them increases and the pool of investment opportunities is expanded.

Enterprise Management Incentives:

"Permanent establishment"

One of the tests a company had to meet to satisfy the qualification criteria to grant tax favoured EMI share options was that the company's qualifying activities needed to be carried out "wholly or mainly" in the UK.

Companies with significant international operations were therefore often prevented from granting EMI options.

However, this test was considered to fall foul of the guidelines and EU treaties regarding the provision of State aid. As a result of negotiations with the UK Government, the EU Commission agreed to grant EMIs State aid approval until April 2018 on condition that the legislation was changed allowing a qualifying company only to have a "permanent establishment" in the UK.

Schedule 5 of ITEPA 2003 (Enterprise Management Incentives) was therefore amended to have effect in relation to options granted on or after 6 April 2010.

Staircase - Eva Jiricna Architects

Removal of the Default Retirement Age on 6 April 2011

Any dismissal on or after 6 April 2011 for retirement will be age discriminatory and unfair unless it falls within the transitional provisions which apply between 6 April – 30 September 2011.

On or after 6 April 2011, employers will no longer be allowed to follow the statutory retirement procedure and will only be able to terminate the employment of older employees fairly for one of the other statutory reasons i.e. misconduct, redundancy, capability, illegality or some other substantial reason.

Employer's Options

Employers have to decide whether to abandon fixed retirement ages altogether or to keep a fixed retirement age in their organisation.

If a business decides to abandon their fixed retirement age, it should remove this from any contracts of employment and any staff handbooks and notify all employees of this change. This is considered to be the safest option for businesses.

If employers decide to keep a fixed retirement age, it will need to be objectively justified. The legal test that employers will need to satisfy will be to show that it is a proportionate means of achieving a legitimate aim. This will be difficult to prove except in certain areas (eg air traffic controllers).

Most businesses are therefore going to struggle to justify a company wide retirement age. If they seek to justify it they will need to provide evidence of a non-discriminatory thinking process.

Alternatives to Compulsory Retirement

Employers should be aware that they can consider a number of alternatives to compulsory retirement such as changes to working hours and working patterns and changes to the nature of the employee's role.