Tax Due Diligence

Kingston Smith

Kingston Smith's Mergers & Acquisitions tax team is a specialist practice that helps its clients review and manage their tax risks in relation to their acquisitions or sale of a business.

How will tax due diligence benefit me?

Tax due diligence can save you a lot of money. If you are looking to purchase a business, it is possible that you could inherit tax costs relating to periods prior to, or events occurring before, you obtain control.

By conducting a tax due diligence we can provide you with detailed information regarding the tax affairs of your potential purchase, as well as help mitigate any risks providing you with protection in relation to any tax liabilities that may accompany the acquisition. It will also enable you to identify the most favourable structure for the transaction, optimising benefits and unlocking previously unclaimed tax recoveries.

What level of tax due diligence do I need?

The level of tax due diligence work will be tailored to suit your individual requirements, be it a full detailed review or a reduced, or more specific review.

In general the scope of tax due diligence can be divided into the following three categories:

Full due diligence

This would provide you with a detailed review, outlining the risks and quantify any contingent liabilities, as well as providing advice as to how these may be managed. This would usually involve reviewing most tax issues for the previous four accounting periods or financial years, plus the current year or period. Specific exclusions may be discussed and included within our engagement terms.

Limited due diligence

Whilst our general advice is that a full due diligence process should be undertaken, you may decide that an exercise with a more limited scope is appropriate. If so we can adjust our scope by:

- Looking at more recent accounting periods only and not looking at the previous four years, for example.
- Simply reviewing information provided by the vendor in response to our due diligence questionnaire rather than a full examination of underlying returns and computations.

Where limited due diligence exposes areas of risk we can recommend a further targeted investigation into these areas. Where this detail is not within the agreed scope, we will bring this to your attention.

Targeted due diligence

It may be that your target company is quite 'young' and the need for detailed due diligence is not so critical. However, there may be a specific area of concern, for example the correct status of contract workers. In this situation it may be appropriate for a you to focus on this area alone.

In all cases our draft due diligence report will be discussed with you and your legal advisers to allow you to consider the impact on the deal structure and the documentation, as well as whether any further investigation is required.

Is this just for purchasers?

Usually, due diligence is an exercise conducted on behalf of the purchaser. However, due diligence can also be part of the pre-sale process for the vendor, reducing the stress in the sales process as well as time and resource.

Pre-sales due diligence for the vendor would need to be conducted at an early stage, probably where a decision to sell has been made or where there is a chance that a realistic offer may arise. The benefit of such an exercise would be to identify matters that can be resolved prior to the purchaser' due diligence process. For example:

- Closing HMRC enquiries.
- Keeping a file of important tax documents such as dispensations, tax clearances, transfer pricing policies and agreements with HMRC on specific VAT matters.
- Ensuring dispensations and HMRC forms/ agreements are in place and correctly filed
- Reviewing entrepreneurs' relief or substantial shareholding exemption to ensure that on a sale these valuable reliefs may be secured.
- Considering the incentivisation and retention of key employees so that they stay motivated to achieve the same goal.

In summary

Tax due diligence is an important component to the overall acquisition or sale process as it reduces risk and saves time. We work closely with our in-house Corporate Finance specialists to provide a seamless service that encompasses the commercial, financial and tax considerations of the deal. We also provide due diligence on potential overseas businesses through our global and professional association Morison KSi.

Finally, it should be acknowledged that limiting the scope of tax due diligence increases the risk of unexpected tax liabilities materialising giving the associated problems regarding recovery form the purchaser. If a client chooses to limit the scope of any tax due diligence no responsibility can be taken by Kingston Smith LLP for any matters that are not discovered as a result of this limitation of scope.

Morison KSi
Independent member