

A guide to buying a property holding company instead of buying the property



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A guide to buying a property holding company instead of buying the property

The cumulative impact of stamp duty land tax (SDLT) increases in recent years has led to an increase in the number of buyers electing to purchase the company which owns an underlying residential property asset, rather than the property itself. This is notwithstanding the Annual Tax on Enveloped Dwellings (ATED) which imposes an annual tax on companies that own UK residential property.

No UK stamp duty is payable on the purchase of shares in a foreign company. The rate for shares in a company incorporated in England & Wales is just 0.5%. With top SDLT rates for a residential property purchase now at 15%, there are therefore potentially significant savings to be made in buying a company rather than the property. For example, the SDLT payable on a £10m purchase at the highest applicable rate would be £1,413,750.

This note is aimed at those considering a company sale or purchase as well as their professional advisors. We have set out the process and some of the key considerations involved in such a transaction.

1. Procedure for a corporate transaction

Early consideration of the full heads of terms is essential. Clearly, it is not only the property that needs investigating but also the company itself, and all assets and liabilities within it. The corporate purchase process involves:

- negotiating the reservation form and any heads of terms and exclusivity terms;
- submitting an information request list to the seller's solicitors to obtain information on the company;
- conducting due diligence on the company and preparing a report highlighting key findings;
- drafting and negotiating the share purchase agreement (SPA);
- reviewing and negotiating the seller's disclosure letter disclosing matters against the warranties in the SPA;
- working with onshore and offshore accountants to review the accounting history of the company;

- liaising with overseas lawyers for input on jurisdiction-specific aspects, including input on the SPA and completion mechanics;
- exchanging and completing the SPA;
- drafting and/or reviewing all ancillary documents relating to exchange and completion (including board minutes of the seller and the company, the resignation of directors, and stock transfer forms etc); and
- a property solicitor and surveyor carrying out the usual due diligence on the property itself.

A corporate purchase transaction is usually therefore slower and can be more complicated than a property purchase. If financing is involved there will be further hurdles to overcome. It is important for all parties to allow enough time in the transaction timetable for this usual due diligence process to be carried out.

2. Understanding the company and the seller

Understanding the nature of the company and its ownership structure is important. Some of the key issues to have answers to at the outset, before agreeing the terms of the deal are:

- is the company a special purchase vehicle (SPV);
- is the underlying holding structure complicated;
- what jurisdiction is the SPV based in;
- has control and management been offshore;
- has there been any trading activity; and
- does the company have any debts/liabilities (including contingent tax liabilities).

Of course, the true picture will only emerge as full due diligence is carried out and detailed information is disclosed by the seller.

On completion of a company purchase, the buyer takes on the company's assets (the property) but

also the company's liabilities such as ongoing litigation, any debts and tax liabilities. Depending on who the seller is, and what they are willing and able to offer the buyer, there are mechanisms which can be used to protect a buyer against inherited potential liabilities.

As a general rule, a seller will seek to impose limits on their potential liabilities under the SPA. For the transaction to be successful, both parties need to be aware of, and willing to take on, the additional risks involved when dealing with a company transaction and to negotiate sensibly.

3. Buyer protections

(a) Warranties and indemnities

The SPA will usually contain warranties and indemnities from the seller offering contractual protections, for example that the company:

- is properly incorporated;
- has no debts/liabilities;
- owns the property;
- accounts give a true and fair view of the company;
- has paid its taxes; and
- is of good standing.

These warranties and indemnities are typically given by the selling shareholders. The buyer will be relying on the covenant strength of those shareholders in the event that they seek to enforce a damages claim under the terms of the SPA if a loss is suffered.

Where the seller itself is an offshore entity and/or has no assets other than the shares in the company these warranties and indemnities alone may not be sufficient comfort for a buyer. Offshore trustees will usually look to limit liability to the assets held from time to time which offers scant reassurance for a buyer. In these circumstances it is common practice for additional buyer protections to be negotiated.

(b) Retention monies held in escrow

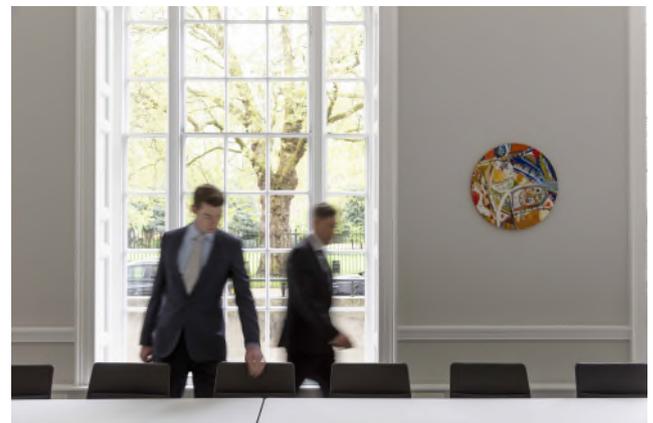
The SPA can provide for an agreed sum to be retained from the purchase price and held in a separate account for a fixed period of time. The (non-tax) warranty limitation period is commonly 12-36 months and ideally a buyer would want the retention held for the duration of the warranty period.

The limitation period of the tax warranties is usually 7 years (the period of time in which HMRC can reopen the tax affairs of a company). It is rare for a seller to be willing to have a retention sum held for this long so the parties will need to negotiate to determine who bears this risk.

(c) Insurance

An insurance policy can be obtained to cover the cost of any warranty claim. This cover can be fairly extensive and may include any costs of defending an action brought by HMRC.

Depending on the policy terms, it may mean that there is no requirement to pursue the seller before a claim is made. Unfortunately this option is not without disadvantages. The insurance company may require their own lawyers to be involved in the initial due diligence process which can have an impact on the transaction timetable. The policies can be expensive and will usually have certain exclusions. The question of who pays the costs of this cover is by negotiation between the parties.



(d) Guarantor (ideally UK-based)

If the ultimate beneficiary (or other connected individual of substance) were willing to stand behind the terms of the SPA as guarantor this would give the buyer greater comfort that they had a party of substance against whom they could enforce the terms of the SPA.

In the event of a warranty breach this party would be pursued through the UK courts. Even though this may still be an expensive process it remains less so, and less opaque, than offshore proceedings.

4. Seller limitations

A buyer will of course be looking for the seller to accept responsibility for the debts and liabilities of the SPV whereas the seller will be seeking to limit its liabilities under the SPA. The seller will not accept an unlimited, open-ended liability. The terms of these limitations will be negotiated, but it is standard practice for the SPA to contain, amongst others, the following limitations:

- no warranty claims in respect of matters disclosed;
- financial limitations on claims including a de minimis (to exclude smaller claims) and a maximum cap (which is often the purchase price); and
- no double recovery.



Conclusion

It is clear that early discussion of the key issues at the stage when price is being discussed and heads of terms of the agreement are being negotiated is essential. This will give the opportunity for any potential deal-breaking issues to be addressed at an early stage. For many clients there are compelling reasons why structuring the transaction as a corporate deal are attractive and it is important that this objective is achieved in the most swift and effective manner.

Key contacts



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Details for the whole of our highly qualified and knowledgeable [Residential Property team](#) can be found on our website.

Further Information

If you require further information on anything covered in this briefing please contact one of our experts or your usual contact at the firm on 020 3375 7000. Further information can also be found on the [Property page](#) on our website.

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