MAYER | BROWN

March 2019

Private Equity Bulletin

Entrepreneurs' Relief – Help with ABCs

Having tightened the tests to be met for Entrepreneurs' Relief (ER), without consultation, the Government has now listened to the industry and produced a solution which should work in most cases.

In order to counter tax planning which had the aim of obtaining undeserved ER, by creating "tailored" shares i.e. shares designed to obtain relief without any real commercial downside risk, the test for ER was widened in the October Budget. Shareholders had previously been required to meet the old test for a "personal company" of having at least 5% of ordinary shares by nominal value and 5% of the voting rights of the company deriving from these shares. The new tests added that with effect from 29 October 2018, the individual should also be beneficially entitled to:

i) at least 5% of profits available for distribution to equity holders; and

ii) at least 5% of assets available to equity holders on a winding up.

No-one could argue that this widening would not have restricted the relief, but it had the unfortunate effect of stopping ER being given in common situations where there was no avoidance. One such instance is alphabet stock: if shareholders A, B and C have A, B and C class shares, they would fail this new test. This is because different dividends could be declared on the different classes and therefore shareholders are not strictly entitled to the profits, as they would never know what they were going to receive until the dividends were actually declared. This would have been the case even if A, B and C each owned a third of the ordinary share capital and there were no other shareholders.

If you have any questions about this update, please get in touch with:

Perry Yam
Partner, Private Equity
T: +44 20 3130 3222
E: pyam@mayerbrown.com

James West
Partner, Private Equity
T: +44 20 3130 3311
E: jwest@mayerbrown.com

Neil Evans
Partner, Private Equity
T: +44 20 3130 3079
E: nevans@mayerbrown.com

Simon Rose
Partner, Tax Transactions & Consulting
T: +44 20 3130 3107
E: srose@mayerbrown.com

Tim Baines
Counsel, Planning & Environment
T: +44 20 3130 3073
E: tbaines@mayerbrown.com

Mark Prinsley
Partner, Intellectual Property
T: +44 20 3130 3900
E: mprinsley@mayerbrown.com

Emily Chen
Trainee Solicitor, Corporate & Securities
T: +44 20 3130 3105
E: emily.chen@mayerbrown.com

After protests from the industry, HMRC announced an alternative test to these new tests. These were announced in December but have effect from 29 October 2018 (Budget day) as if this had been the drafting all along. This alternative test measures "...whether in the event of a disposal of all of the ordinary shares, the individual in question would receive at least 5% of the proceeds." If so, provided the old tests were also met, the relief would be available. Therefore if in our example A, B and C each receive a third of the sale proceeds, then they would obtain ER despite not being technically entitled to dividends and assets on a winding up.

Preparing Technology Arrangements for Brexit

The ultimate form of the UK's exit from the European Union shall remain a hotly debated topic.

The purpose of this article is to highlight some key risks of either the No Deal scenario or a deal on the terms of the Draft Withdrawal Agreement (as advocated by Prime Minister Theresa May) which relate specifically to technology arrangements and the steps to mitigate these risks.

1. PERSONAL DATA ISSUES

UK businesses will need to consider the basis upon which personal data can be transferred internationally. The UK government has indicated that it will (continue to) treat the remaining EU countries as having adequate data protection regimes, so no additional steps will need to be taken to transfer personal data to the remaining EU countries.

What is currently less clear is whether transfers of personal data from the remaining EU countries to the UK will be permitted on the basis that the UK is deemed to (continue to) have an adequate data protection regime, especially in a No Deal scenario. The simplest solution is likely to be putting in place the EU approved Standard Contractual Clauses.

Businesses exporting personal data from the UK to third countries will also have to ensure that they comply with the UK specific rules on export of personal data from the UK to third countries. A particular point to look out for is whether all the countries which the EU has accepted as having an adequate data protection regime will be regarded by the UK as also having an adequate data protection regime.

2. PROTECTION OF DATABASES

When the UK leaves the EU, the EU Database Directive, which created the Sui Generis right to protect databases, will cease to apply to the UK. Under the Draft Withdrawal Agreement, a database will continue to be protected where it is created by UK nationals, natural persons with habitual residence in the UK or businesses established in the UK. In the No Deal scenario, the ironic position will be that EU nationals, residents and businesses in the UK will acquire the Sui Generis right when they develop databases in the UK but UK nationals, residents and businesses will not.

UK domestic businesses can minimise the risk of losing protection for databases developed in the UK by involving developers with an EU connection. Also, the database would be protected internationally through the copyright system if sufficient creativity can be established for the database to be protected as a copyright work.

3. FREE MOVEMENT OF GOODS

Fractured supply chains is an area of concern in a No Deal scenario for technology arrangements where continued access to hardware and consumables will be required. To prepare for this, businesses should be revisiting their supply chains and inventory to ensure that the impact of delays in customs processes etc. are minimised.

In the Draft Withdrawal Agreement scenario, the disruption should be minimal as goods first lawfully put on the market in the EU or in the UK prior to the end of the transition period can circulate between the two markets before they reach the end user.

4. FREE MOVEMENT OF PEOPLE

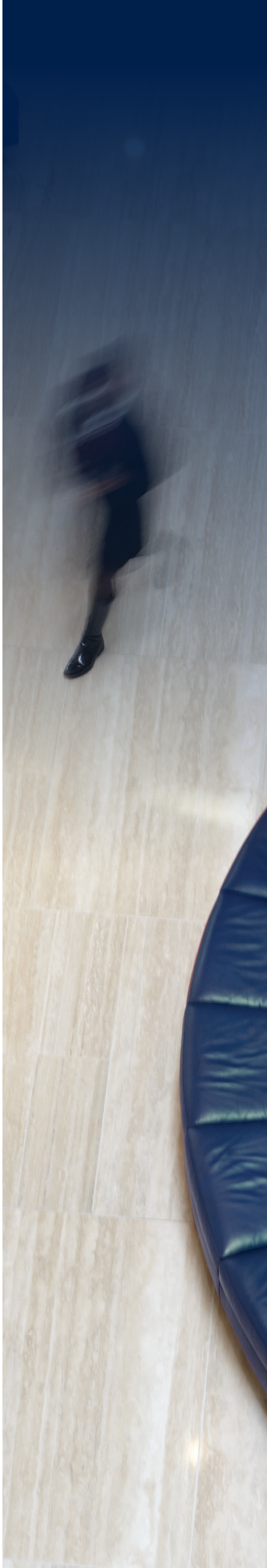
Businesses should carry out a 'people audit' to map out the locations of the direct workforce and, for outsourced arrangements, those of its third party suppliers.

Regardless of the outcome of the EU negotiations, the UK government will proceed with its settlement scheme which will allow EU nationals to apply for settled status, provided they have arrived in the UK by the end of 2020. Businesses should consider helping those who qualify for the scheme to take advantage of it, particularly if they are in key roles.

In relation to UK nationals based in the EU, some EU governments—for example the Netherlands—have made welcoming noises, promising measures to allow such individuals to remain there after March 2019 in the event of a No Deal scenario. Businesses should focus on those EU countries that are most relevant to its workforce and monitor developments of any such legislation.

5. REVIEW TECHNOLOGY SUPPLY AGREEMENTS

For all material technology arrangements contractual frameworks should be reviewed in the context of Brexit. Key areas to review include: (1) Pan-European arrangements, (2) territorial scope of licences, (3) location of personal data, (4) rights in databases, (5) currency/inflation indices, (6) compliance with laws obligations and (7) TUPE/ARD on termination.



Goodbye CRC Energy Efficiency Scheme, hello Streamlined Energy and Carbon Reporting

It must have come as a big relief to many private equity investors when the 2016 Budget finally killed off the CRC Energy Efficiency Scheme (**CRC**) (following the 2018-19 compliance year). The CRC, which was intended to incentivise energy efficiency and cut emissions in large energy users, quickly became an administrative headache. It required compliance entities to buy and surrender allowances in respect of their group emissions. One of the most tricky aspects of the CRC for private equity was identifying which elements of a group were deemed to fall within the same group for CRC scheme participation. The LLP, portfolio companies, general partner, fund manager and limited partners were all able to be participants within the CRC. Changes to groups over time posed a particular problem, particularly with reference to collating all the relevant information in respect of the relevant periods.

The abolition of the CRC does not necessarily mean that investors are home and dry: Streamlined Energy and Carbon Reporting (**SECR**) will be introduced in its place. The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 come into force on 1 April 2019. They apply in respect of financial years beginning on or after 1 April 2019. A guidance document on the reporting requirements was published in January 2019.

The Regulations require additional reporting on emissions, energy consumption and energy efficiency action by quoted companies, large unquoted companies and large LLPs. By way of an example, large LLPs will be required to prepare an energy and carbon report for each financial year and report on:

- Annual quantity of GHG emissions arising from the activities for which the LLP is responsible for in respect of combustion of gas / transport fuel
- Annual quantity of GHG emissions resulting from the purchase of electricity by the LLP for its own use, including for transport
- An intensity metric (e.g. GHG emissions / number of employees)
- Total UK energy use.

Disclosure of scope 3 (energy indirect) emissions is voluntary. Some of the above requirements are new for LLPs. In certain circumstances, reports must be consolidated group reports. The requirement to prepare an energy and carbon report only applies to LLPs that satisfy at least two of the following criteria:

- More than 250 employees
- Annual turnover greater than £36 million
- Annual balance sheet total greater than £18 million.

Despite the "roll back" of the CRC, there is an increasing focus on environmental, social and governance (ESG) and carbon/climate reporting:

- The Task Force on Climate-related Financial Disclosures (**TCFD**) has developed voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders.

The Task Force released its first Status Report in September 2018, by which time 513 organizations had expressed their support for the TCFD recommendations. TCFD is particularly innovative in its requirement for organisations to test themselves against future climate scenarios.

- The Principles for Responsible Investment (**PRI**) are a voluntary and aspirational set of investment principles that offer possible actions for incorporating ESG issues into investment practice. A recent report found that US$1.1trn is invested indirectly by 349 PRI signatories via externally managed private equity funds and US$1.05trn is invested directly by 431 signatories in private equity assets. This accounts for approximately one third of global private equity assets under management. For signatories that reported in both 2015 and 2018, more than one third have processes in place to link Responsible Investment objectives to the their portfolio managers' and investment analysts' key performance indicators. TCFD reporting will become mandatory for PRI signatories in 2020.
- The EU Commission launched its action plan on financing sustainable growth in March 2018. One of the first legislative proposals to come out of that plan would implement disclosure requirements on how investors (including private equity) integrate ESG factors in their risk processes. The legislation is currently making its way through the EU legislative process.

Those who were relieved by the abolition of the CRC may nonetheless face increasing scrutiny of their ESG performance going forwards, some of which may be broader and more penetrating than the requirements of the CRC. Other private equity investors are seeing good ESG performance as a way to boost value and enhance investor appeal.

Our Private Equity practice

Mayer Brown is a leading international legal adviser to a vast array of private equity funds, portfolio companies and management teams. Mayer Brown's Private Equity practice is unique with representation across four continents. Our private equity team aims to deliver creative and practical solutions to the often complex issues faced by our clients in today's business environment.

Our private equity clients span a range of fund structures and geographic or industry focus, including traditional private equity funds, captive funds, pledge funds, venture capital funds, infrastructure funds, real estate funds, funds of funds, secondary funds and debt and mezzanine funds. We also regularly represent portfolio companies and management teams in a wide range of private equity transactions. We pride ourselves on forging long-term relationships with our clients that begin with fund formation and continue throughout their investment activities and exit strategies.

Our cross-practice teams are led by a global team of seasoned lawyers with extensive transactional experience.

Mayer Brown at a Glance

Approximately
1,500
lawyers worldwide

250
Chambers-ranked Lawyers

26
offices located in the Americas, Asia, Europe and the Middle East

Clients'
global, cross border legal needs all fully supported

Law 360 2017 included Mayer Brown, for the seventh consecutive year, in their Global 20 list of law firms with the greatest worldwide reach and expertise.

BTI 2017 Client Service Top 100

For the seventh straight year, Mayer Brown has been recognised by corporate counsel as one of the BTI Most Recommended Law Firms. Mayer Brown was one of only 19 firms recommended in this category for more than five years in a row by corporate counsel.

Mayer Brown is a distinctively global law firm, uniquely positioned to advise the world's leading companies and financial institutions on their most complex deals and disputes. With extensive reach across four continents, we are the only integrated law firm in the world with approximately 200 lawyers in each of the world's three largest financial centers—New York, London and Hong Kong—the backbone of the global economy. We have deep experience in high-stakes litigation and complex transactions across industry sectors, including our signature strength, the global financial services industry. Our diverse teams of lawyers are recognized by our clients as strategic partners with deep commercial instincts and a commitment to creatively anticipating their needs and delivering excellence in everything we do. Our "one-firm" culture—seamless and integrated across all practices and regions—ensures that our clients receive the best of our knowledge and experience.

Please visit mayerbrown.com for comprehensive contact information for all Mayer Brown offices.