

UK Investment: Tech Issues for Entrepreneurs, Start-Ups and Investors

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technology
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presenters

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Introduction

London's Tech City started off small in 2008 consisting of a small cluster of Tech and Design companies in an area coined the "Silicon Roundabout".

In 2010, the UK government put its weight behind it and announced the loosening of visa restrictions for entrepreneurs who wanted to set businesses in London and it was rebranded as "Tech City."



Today, London's Tech City is the 3rd largest technology startup cluster in the world after San Francisco and New York City.

Why the UK?

Based on the World Bank Doing Business survey, the UK is ranked top in Europe in terms of ease of doing business and fourth in the world. This is based, in part, on the following factors:

- The UK Government has established an entrepreneur's visa and also created tax breaks for early-stage investors.
- International workforce, appeals to global talent, and English language.
- Time is on London's side – Greenwich Mean Time – it is a globally connected market ideally set between the East and the West.
- Commercial-minded location – with a well-established and reputable jurisdiction to do business. There are no currency or exchange controls or restrictions on foreign investment.
- It has one of the largest treaty networks.

Factors to Consider

- Foreign business coming to the UK should be aware that accounts of all UK companies are subject to public disclosure.
- The UK government has recently introduced measures to simplify and make the tax compliance process easier for companies to understand, however, UK tax regulatory practices need to be considered when coming to the UK and there is still complexity of tax legislation, particularly related to overseas operations.
- The scope of personal taxation varies depending on an individual's stay in the UK and whether they are domiciled in the UK.
- New immigration rules introduced in 2008 mean that procedures for visiting and working in the UK have changed recently and companies should ensure that they are following these procedures.
- UK employment law does not allow for termination of an employee's contract of employment "at will" by the employer, in the sense that concept is used in US jurisdictions.
- IT Companies need to take active steps to protect its IP, since many rights are territorial in nature, to ensure protection and enforcement in the UK.

Options to enter the UK market

- Establishing your own legal entity
- Operating as an overseas entity (i.e., branch office)
- Acquiring or investing in an existing company
- Hiring an independent consultant or design company

Option 1 – Establishing a new legal entity

- There are 4 main types of corporate legal entities in the UK, which are governed by the Companies Act 2006:
 - private company limited by shares (Limited) – the members' liability is limited to the amount, if any, unpaid on the shares allotted to them – this type of entity is the most common type of entity used by overseas entities.
 - public limited company (PLC) – the members' liability is limited to the amount, if any, unpaid on the shares held by them. Minimum share capital is £50,000. Only the shares of a PLC can be offered for sale to the general public.
 - private company limited by guarantee – the company does not have a share capital and the members' liability is limited to the amount that they have agreed to contribute to the company's assets if it is wound up (normally a nominal amount). This type of company is used principally for charitable organisations and clubs.
 - private unlimited company – there is no limit to the members' liability.
- Other options include establishing a partnership under English law or a European Public Company (*Societas Europaea*).

Option 1 – Establishing a new legal entity

- The following applies to both a Limited and PLC entity:
 - Both entities require the same corporate documentation (e.g., a memorandum of association) and take 3-5 days to form with same day service available for an additional fee.
 - There are no residency or nationality requirements for directors of UK Companies.
 - Both have a separate legal establishment and shareholders are not liable for any acts or omissions of the company.
- Key Differences:
 - It is currently possible for a Limited, but not a PLC, to receive flow-through treatment for US tax purposes, by election under the so-called “check the box” rule.
 - Share capital requirements (£1 vs £50,000), PLCs require a company secretary, must hold annual meetings, can only pay distributions from distributable reserves and if its net assets do not fall below an amount calculated by reference to its share capital and reserves.

Option 1 – Tax Considerations

- **Corporation Tax**
 - A UK subsidiary of an overseas company (like any other UK resident company) will pay corporation tax on its UK sourced profits, and if it elects on certain foreign profits, subject to double tax relief for foreign taxes. The basic rule is that all companies that are incorporated in the UK and all companies whose central management and control is exercised in the UK are resident in the UK for tax purposes.
- **Taxation of Dividends**
 - Dividends declared and paid by a UK resident company are not subject to withholding tax. Where profits are repatriated by the UK subsidiary, by way of dividend to a company or to an individual resident outside the UK, the applicable tax laws in the jurisdiction of the recipient will determine how the recipient is taxed on receipt of the dividend.
- **Tax on interest**
 - A company resident in the UK that makes yearly payments of interest to a non UK resident must withhold tax on interest at a rate of 20%. Where interest is paid to a company resident in a country that has a double tax treaty with the UK, such interest payments may be reduced or exempt from withholding tax. The UK generally has fairly generous rules permitting deduction of interest, although it does have a strict thin capitalisation regime restriction tax deductions for interest if the company has excessive related party debt funding.

Option 1 – Tax Considerations (cont)

- R&D Incentives
 - R&D is defined for tax purposes as occurring when a project is undertaken to achieve an advance in science or technology.
 - The R&D tax credit is claimed as a deduction (from the company's taxable income) at a rate of 225% of the qualifying R&D expenditure incurred on or after 1 April 2012 for small and medium sized enterprises.
- Patent Box Regime
 - Optional 10% UK corporate tax rate for profits attributable to patents and similar intellectual property.
- Cross-border interest and royalty payments
- Value Added Tax (VAT)
- Pay As You Earn (PAYE)

Option 1 – Employment Considerations

- Written Contracts
- Dismissing an employee
 - Unfair dismissal/Automatic unfair dismissal
 - Remedies for unfair dismissal
 - Redundancies
 - Minimum Notice Requirements
 - Restrictive Covenants

UK Immigration Considerations

- For all non-EEA/Swiss nationals (“foreign nationals”), it is illegal to work in the UK unless some form of authorisation has been obtained from the UK Border Agency.
- Tier 1 and Tier 2 categories and requirements. For short-term, temporary business visits, it may be appropriate to obtain a business visitor visa.
- Working as, or employing, a foreign national who does not have authorisation to work is a criminal offence.
- Penalties for employers’ non-compliance range from written warnings, sponsorship licence revocation or on-the-spot fines to criminal sanctions, which may include more substantial fines and imprisonment.

UK Immigration Considerations (cont)

- Work permission:
 - Tier 2 of UK Points Based System
 - Tier 5 Youth Mobility Scheme
 - Representative of an overseas business
 - Entrepreneurial route
- Personal immigration permission:
 - Relationship with EU national or British national
 - Other nationalities
 - Ancestry

Tier 2 – Sponsorship Licence

- UK immigration permission to sponsor a skilled worker from outside the European Economic Area (EEA) to undertake a skilled role for a specific employer.
- Employer must hold a Tier 2 Sponsor Licence.
- To apply for a Tier 2 Sponsor Licence, the employer must be a genuine operation in the UK, and have at least one employee based in the UK.
- Employer must submit various corporate documents to the Home Office to support the Sponsor Licence application.
- Processing times for Sponsor Licence applications currently 3 to 4 months.
- Once approved, the sponsor is granted access to an online “Sponsorship Management System.”
- This system is then used to issue “certificates of sponsorship” (a virtual “work permit”) to the applicant.

Tier 2

- Transferring a non-EU national to the UK by virtue of Tier 2 is a two-step process.
 - Employer must issue a Certificate of Sponsorship to the employee for a skilled role;
 - Employee must apply for entry clearance (i.e., a visa) to the UK, together with any dependant family members.
- Tier 2 has several sub-categories.
 - Tier 2 (Intracompany Transfer) is used for employees of a multinational company that are being transferred to a UK based branch of the same organisation.
 - Tier 2 (General) is used for skilled jobs that cannot be filled by a settled worker.

Tier 5 Youth Mobility Scheme

- Can live and work in the UK for up to 2 years.
- Must be aged 18 to 30.
- In order to be eligible to apply, the applicant must be a national of one of the following countries:
 - Australia
 - Canada
 - Japan
 - Monaco
 - New Zealand
 - Hong Kong
 - Republic of Korea
 - Taiwan

New Visa Routes for Technology Sector

- **Exceptional Talent Visa**
 - The UK Home Office introduced 200 endorsements by TechCity UK from 6 April 2014 – 5 April 2015;
 - An applicant must be internationally recognised at the highest level as a world leader in his/her field or demonstrate “exceptional promise” such that he/she is likely to become a world leader.
- **Tier 1 (Graduate Entrepreneur) Visa**
 - Introduced to encourage graduates studying in the UK with entrepreneurial skills to remain for a further year to develop a business idea;
 - Can be endorsed by UK Trade and Investment or selected educational institutions.

Personal Options: Relationships and other Nationalities

- Consider whether the individual has an ongoing relationship with an EEA national or a British citizen.
- May be eligible to apply for a UK visa or an EU Family Permit on the basis of this relationship, which would allow the individual to live and work in the UK.
- This can include unmarried partners and same-sex couples, depending on whether the couple can show evidence of a genuine relationship.
- Consider whether the individual is a dual national.
- Explore whether the individual has any claim to other nationality.
- EU nationals have the right to live and work in the UK without restrictions.

Option 2 – Branch Office

- If you decides not to create a legal entity in the UK through which to carry on your UK business, you may still be subject to certain requirements under English law; overseas entities selling goods or providing services to customers in the UK (or contemplating such activity) need to consider whether their activities establish a “presence” in the UK giving rise to a liability for UK taxes and or to an obligation to make public filings.
- If an overseas entity has not set up a legal entity in the UK, but has a “permanent establishment”; it will be required to comply with certain registration requirements under the Companies Act 2006.
- The profits attributable to any trading activities of any branch operation (or permanent establishment) in the UK will generally be subject to taxation in the UK. Any dealings with head office will be deemed to have been remunerated in the UK at arm’s length rates under “transfer pricing” principles, which can result in tax on profits exceeding cash profits.
- Registration of a branch office or place of business must be done within 30 days of establishment.

Option 2 - Representative of an Overseas Business

- The individual must be coming to the UK as the sole representative of an overseas company planning to set up a UK branch or wholly owned subsidiary for an overseas parent company.
- Must be recruited and employed outside the UK by a company whose headquarters are outside the UK.
- Must have extensive related industry experience.
- Must hold a senior position within the company.
- Intention must be to establish the company's first commercial presence in the UK (e.g., a registered branch or a wholly owned subsidiary).

Business Visitor to UK

- Not an alternative to Tier 2!
- Consider the activities to be undertaken in the UK rather than the amount of time to be spent in the UK.
- Business visitors cannot engage in “productive” work in the UK with some exceptions called “permitted business visitor activities.”
- Permitted activities are very limited. Examples of permitted activities include:
 - attending pre-arranged business meetings
 - attending a one-off conference
 - conducting site visits
- If a business visit, even if very brief, will involve other activities which constitute an individual’s day to day role, they would need to ensure that they hold a UK immigration permission to allow them to work in the UK, such as a Tier 2 visa which they will need to apply for before travelling to the UK.

Option 3 – Acquiring or Investing in an established Entity

- The process and transaction documents for the acquisition of a UK entity is similar to acquiring a US entity.
- Key due diligence issues to consider when acquiring an IT entity, include:
 - Whether the target company owns or has sufficient rights to use all material IPR
 - Reliable pipeline of new products and revenue from existing clients
 - Acceptable litigation exposure
 - Post-contractual services, maintenance and support requirements
 - Technology infrastructure
 - Appropriate systems, policies and procedures

Option 3 – Tax Considerations

- Where shares are acquired, like in the US, a buyer will also assume the historic liabilities of the business.
- As in US acquisitions, it is typical for a buyer to require protection for such historical liabilities through tax warranties together with a tax indemnity in favour of the purchaser. The warranties are designed to flush out information about the target company. In the tax indemnity, the seller and the buyer will apportion tax liabilities between them. Generally, the buyer will be responsible for post-completion tax liabilities and the seller will be responsible for pre-completion tax liabilities (together with any specific “post-completion” liabilities suffered by the target company for which the seller will accept financial responsibility).
- Stamp duty is a transfer tax levied on transfers of certain securities. The buyer of shares in a company incorporated in the UK is required to pay stamp duty on the consideration for the shares transferred at 0.5%.

Option 3 – Employment Considerations

- As a result of EU Directives, the Transfer of Undertakings (Protection of Employment) Regulations 2006 (“**TUPE**”) operate to protect employees where there is an acquisition of a business.
- TUPE provide that when a business transfer occurs, the employees assigned to that business or economic activity transfer as well and their terms and conditions of employment remain unchanged following the transfer.
- The buyer of a business also assumes liability for the employees working in that business.
- Any dismissal in connection with the transfer is deemed automatically to be unfair, unless it is for an economic, technical or organisational reason.
- TUPE would also apply to business transfers within subsidiaries of the same holding company.

Option 4 – Consultancy Arrangement

- Often parties will first enter into a service arrangement prior to acquiring a company.
- The benefits include:
 - It allows you to test the market and the skills of the company prior to purchasing.
 - It can be cost effective
 - If appropriately structured, the non-resident will not be responsible for the UK consultant's employment related taxes or social security, nor will the consultant create a taxable presence for the non-resident in the UK.

Option 4 – Consultancy Arrangement

- Issues to consider when entering such arrangement:
 - TUPE has broad application - it can apply to outsourcings and other commercial arrangements. The third party contractor assuming outsourced work therefore also assumes liability for the employees working in that business.
 - Application of restrictive covenants – although they are typically contained in such contracts, they are difficult to enforce in English courts.
 - Data Protection Considerations
 - Competition Considerations – anti-competitive agreements

Questions?

Our Team



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Amy Comer advises on a wide range of cross-border technology transactions, including business process and information technology outsourcing (ITO). Typical matters include software licences, ASP arrangements, technology development agreements, privacy policies and website terms of use, master service agreements, and wholesale carrier agreements. Ms. Comer is also experienced with media and entertainment matters, including the distribution and licensing of films, television programs, and music. As a substantial part of her practice, Ms. Comer focuses on "emerging market" countries such as Russia and Kazakhstan, and frequently works from our offices in Moscow and Almaty.

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Tracy Evlogidis is a partner in Morgan Lewis's Labour and Employment Practice. With more than 15 years practicing solely in the field of immigration and nationality law, Tracy provides corporate and individual clients with strategic advice helping them navigate through all the complexities of the UK immigration system — regardless of the scale or nature of the issue. As a global mobility specialist, Tracy represents multinational corporate clients across a wide range of industries including financial services, technology, retail, education, and legal services, assisting them with the development of their immigration policies and practices. She advises on employee relocation programmes and international assignments, guiding clients through each step of the process, from the initial visa application, permanent residency, to British citizenship. With thorough knowledge of the Point Based System, Tracy also advises on sponsorship applications and assists sponsors with investigations for immigration compliance, including providing detailed, hands-on preparation for UK Border Agency audits.

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