corporate financial management

CASHBOX PLACING

Open the box

EDWARD JONES AND **LYDIA CHALLEN** EXPLAIN WHAT A CASHBOX PLACING IS AND HOW TO STRUCTURE ONE.

A cashbox equity placing can be carried out by a company (the issuer) that wants to raise equity capital by a placing of shares in the market. Historically, cashbox placings were used only to raise equity funds to finance or refinance an acquisition but now they are more commonly used for pure cash raising where circumstances permit. They are usually conducted through an accelerated bookbuild by an investment bank, but can be structured directly with a strategic investor without the need for an investment bank. In this article we assume that a broker is involved.

A typical cashbox placing involves the establishment of a newly incorporated company, let's call it CashboxCo, with a small number of ordinary shares. The majority (but less than 90%) of the shares are held by the issuer and the balance is held by the broker: this is relevant for merger relief. The following steps then take place:

- **The broker** agrees to subscribe for redeemable preference shares issued by CashboxCo and undertakes to pay the subscription price for them to CashboxCo. This obligation is conditional on the admission of certain new shares (placing shares) to be issued by the issuer for listing and trading.
- **The issuer** agrees to purchase the preference shares and the ordinary shares held by the broker. The consideration given by the issuer for this purchase is the allotment of the placing shares to placees selected by the broker (or to the broker itself where the placing is being underwritten by the broker and placees cannot be found for the placing shares).
- **Placees** pay the broker for the placing shares and the broker uses the monies received to discharge its obligation to subscribe for the preference shares.
- **The preference shares and ordinary shares** held by the broker are sold to the issuer.
- **If the placing does not close**, in carrying out put and call options the broker is entitled to require the issuer to purchase the ordinary shares, and the issuer is entitled to require the broker to do so. In each case the purchase would be for an amount equal to the price paid by the broker to acquire the shares (ie, a nominal sum).

Executive summary

- Given the current difficulties in the credit markets and the apparent investor appetite for equity investments, an opportunity exists for companies to use a cashbox placing as a way of generating funds.

The net result of these steps is that the issuer holds all the share capital in CashboxCo, which itself holds the cash proceeds from the placing shares. Thereafter, CashboxCo might lend the proceeds to the issuer or choose to redeem the preference shares.

WHY UNDERTAKE A CASHBOX PLACING? A cashbox structure permits a cash placing to be implemented without regard to shareholders' pre-emption rights contained in the Companies Act 1985 (and from 1 October 2009, in the Companies Act 2006). This is because pre-emption rights apply only to cash issues and a cashbox placing does not involve an issue of shares for cash. Instead, the cashbox placing is treated as an issue of shares for a non-cash consideration: namely, the transfer to the issuer of the preference shares and the balance of the ordinary shares.

The Association of British Insurers (ABI) has issued guidelines relating to vendor placings which practitioners have historically relied on for cashbox placings. Under the guidelines, a vendor placing in excess of 10% of the issued share capital (or at a discount to the market price in excess of 5%) should be subject to clawback to give

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existing shareholders the opportunity to participate.

However, the ABI has recently raised concerns over the "abusive" use of cashboxes. The risk of a challenge to the validity of a non-acquisition related cashbox placing will probably be mitigated where shareholders or the ABI have been consulted in advance of the transaction.

A cashbox placing can be carried out in a relatively short timeframe – say one to two weeks. In general, the issuer should not have to publish a prospectus as long as the shares to be issued do not result in more than 10% of the issuer's pre-existing issued share capital being admitted to trading on a regulated market over a 12-month period.

UK TAX ISSUES Typically, CashboxCo will be incorporated in Jersey, which offers company law and stamp duty advantages. In cashbox transactions to date, CashboxCo has typically been tax-resident in the UK (a status that can be achieved by holding board meetings in the UK) to avoid the possible application of rules that would require HM Treasury consent before the issue of any shares by CashboxCo.

These rules are due to be replaced with effect from 1 July 2009, with an obligation to make a report after certain transactions (with a value in excess of £100m) have been carried out.

In future, issuers may well consider using cashbox companies that are not tax-resident in the UK. However, if the intention is to lend the proceeds in CashboxCo to the issuer after completion of the placing, the use of a CashboxCo that is tax-resident outside the UK may be tax-inefficient from a UK perspective.

▪ **Stamp duty** Care needs to be taken over the drafting of the placing agreement to ensure that no liability to stamp duty reserve tax is generated. The issue is whether the broker can be said to have transferred any right to an allotment of placing shares to placees. It is therefore important that the agreement only provides for the broker to have any right to the placing shares to the extent that it acquires them as a result of its underwriting obligations.

No stamp duty or stamp duty reserve tax should arise on the issue of shares in CashboxCo. If CashboxCo is incorporated outside the UK, and its share register is maintained outside the UK, no stamp duty reserve tax should arise on the agreement to transfer the preference shares.

In practice, no stamp duty should need to be paid on the stock transfer form transferring the preference shares to the issuer provided the stock transfer form is executed and kept outside the UK. It would be necessary to pay stamp duty in order to rely on the stock transfer form before the UK courts but it is difficult to conceive of circumstances where this would be necessary.

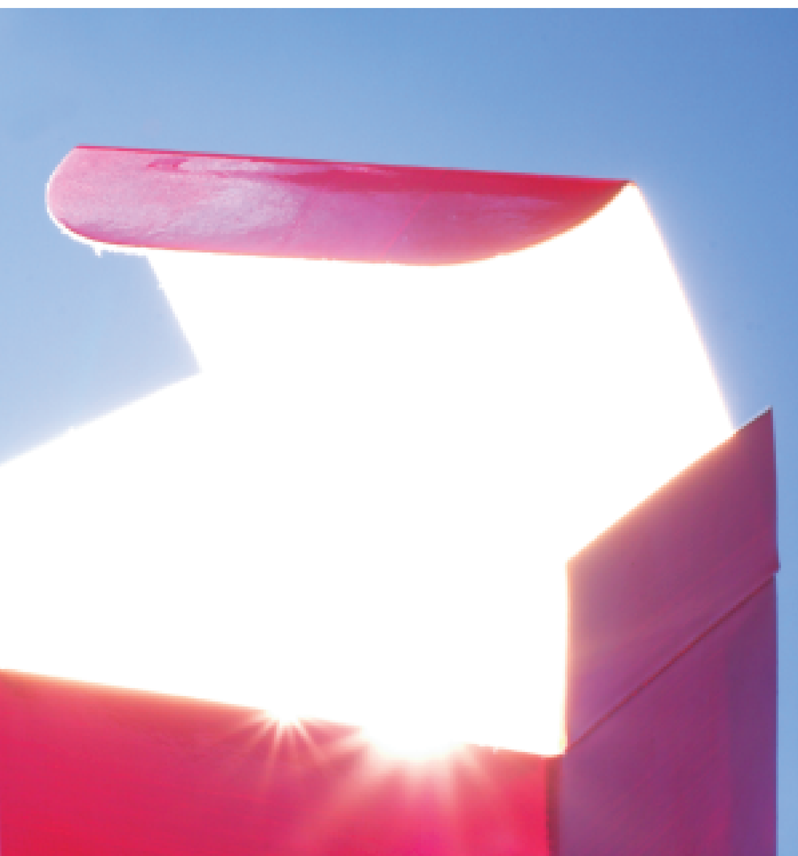
▪ **Taxation of preference shares in the hands of the issuer** The Budget in April confirmed the government's intention to introduce legislation in this year's Finance Bill which will provide that:

- amounts economically equivalent to interest will be taxed for UK corporation tax purposes as if they were interest; and
- in certain circumstances, a company holding fixed-rate redeemable preference shares which are accounted for as a financial liability by the issuer will be treated for UK corporation tax purposes as if the company holding the shares were a lender to the issuer rather than a shareholder.

The effect of these rules would be that any distribution arising from the preference shares would be taxable for the issuer as if it were an interest receipt. However, it is proposed that the new rules will not take effect as long as the arrangement is not primarily for tax avoidance purposes; it would appear likely in the context of a typical cashbox placing structure that no such tax avoidance purpose would exist.

These rules are probably of limited relevance if the intention is to redeem the preference shares shortly after the transaction has closed. The redemption of the preference shares constitutes a disposal of those shares by the issuer for the purposes of corporation tax on chargeable gains. The amount subscribed for the preference shares would be returned to the issuer and so the proceeds of the issuer's disposal of the preference shares should be equal to the amount subscribed by placees for the placing shares.

The consideration which the issuer gives for the preference shares is its issue of placing shares to placees. By reference to case-law



IF THE INTENTION IS TO LEND THE PROCEEDS IN CASHBOXCO TO THE ISSUER AFTER COMPLETION OF THE PLACING, THE USE OF A CASHBOXCO THAT IS TAX-RESIDENT OUTSIDE THE UK MAY BE TAX-INEFFICIENT FROM A UK PERSPECTIVE.

CARE NEEDS TO BE TAKEN OVER THE DRAFTING OF THE PLACING AGREEMENT TO ENSURE THAT NO LIABILITY TO STAMP DUTY RESERVE TAX IS GENERATED. THE ISSUE IS WHETHER THE BROKER CAN BE SAID TO HAVE TRANSFERRED ANY RIGHT TO AN ALLOTMENT OF PLACING SHARES TO PLACEES.

principles[1], it should be possible to conclude that the issuer's cost of acquisition of the preference shares should be taken to be the amounts subscribed by placees for the placing shares (even if this differs from the quoted price for the placing shares on the date of issue). Accordingly, the disposal proceeds for the issuer on the redemption of the preference shares should be equal to its cost of acquiring those shares and no chargeable gain should arise for the issuer.

■ **Put and call options over ordinary shares** It is likely to be the case that both the put and call options (relating to the ordinary shares to be issued by CashboxCo) would be within the scope of the UK tax regime for the corporate taxation of derivatives. Accordingly, they would be taxable for the issuer on an income basis on movements (if any) in the fair value of the options in its accounts.

However, it seems unlikely that this would bring any material amounts into account because:

- the options would have only a nominal value (on the basis that they relate to the ordinary shares, which have little value); and
- the market value of the options would not fluctuate because the market value of the ordinary shares should not change while the options are outstanding.

■ **Fees** Should the issuer or CashboxCo bear the costs of the capital raising? In the absence of any factors suggesting a different answer, the issuer should probably bear these costs if the capital raising is being undertaken for the benefit of its business. It is unlikely that the issuer will be able to deduct the underwriting fees for the purposes of computing its trading profit chargeable to corporation tax because the fees are likely to be regarded as a capital item.

There may be some scope for arguing that certain other fees (for example, fees payable for advice given prior to the placing as to the likely City reaction to the announcement of the placing) should be deductible in computing the issuer's profits, either as a trading deduction or as an expense of management. The issuer might be able to argue that fees in this category are incurred to assist in the preservation of its trading reputation or that of its subsidiaries. There remains a risk that such fees will be regarded as capital and will therefore be non-deductible.

Certain of the supplies made to the issuer should be exempt for VAT purposes; in particular the underwriting fees will be exempt[2].

To the extent that taxable supplies are made, the VAT chargeable on supplies made to the issuer for the placing should be regarded as residual input tax (in other words, not attributable to any supply). VAT chargeable on such supplies should be recoverable for the issuer in accordance with its partial exemption method.

Although UK tax issues do arise in relation to a cashbox placing, typically such issues should not be allowed to drive the structure except, perhaps, in relation to what to do with CashboxCo after the transaction has completed.

Edward Jones is a senior associate at Allen & Overy.
Lydia Challen is a partner at Allen & Overy.
edward.jones@allenovery.com
lydia.challen@allenovery.com
www.allenovery.com

Footnotes:

1 Stanton v Drayton [1982] STC 585, House of Lords.
Consideration may need to be given to what drafting should be included in the agreement for the acquisition of the preference shares by the issuer to support this analysis
2 Value Added Tax Act 1994, Sch 9, Note 5A