Hogan Lovells

M&A Update

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What dealmakers need to know about the UK election result and its impact on UK investing in 2020

The result of the UK's third general election in less than five years marks a significant shift in the political landscape in the world's 5th biggest economy. After nearly a decade marked by political stalemate, the Conservative party now has a clear majority and authority to pursue its chosen Brexit strategy and manifesto commitments for the UK and its engagement with the rest of the world.

Deal Dynamics, the exclusive Hogan Lovells tracker of global M&A activity, has consistently demonstrated that inbound UK M&A has been remarkably resilient in the face of Brexit headwinds. The three years since the Referendum showing little, if any, discernible weakness relative to the levels of activity globally.

Will the election of a Government with a clearer mandate than at any time in the last decade make a difference for investors? Is it likely to change the attractiveness of particular assets in Britain? Should dealmakers look at the UK differently in 2020?

Here we explore some of the incoming Government's manifesto policies and what those might mean for UK M&A in 2020 and beyond.

Brexit

The cornerstone of the Conservatives' election campaign has been their pledge to deliver Brexit. So their victory means that the UK's exit from the European Union is now almost inevitable. It will almost certainly happen by the end of January 2020.

For business this creates a degree of certainty in the short term. The deal between the UK and EU guarantees a transition period meaning that radical change is unlikely for the remainder of 2020.

In the medium term a degree of Brexit uncertainty remains. To avoid a "hard Brexit", the UK and EU will need to reach a further deal of some sort by the end of 2020. This means that those looking to do deals involving the UK over the coming months will still need to consider Brexit – in appropriate cases, deal terms will need to reflect the potential implications of various possible outcomes.

Politically however the last three years suggest both the UK and the EU will want to avoid a "no deal" outcome so some form of longer term accommodation remains likely.

The new Government's vision of a post-Brexit Britain places great weight on a high-tech, high-skill, innovation-led economy which looks globally rather than to the EU for its trading relationships. This theme runs through its manifesto beyond Brexit and will set the climate for investment in the UK over the coming years.

Regulation

One of the biggest differences between this Government and its immediate predecessor is its desire to uncouple UK regulation from that in the EU. Over time we are therefore likely to see divergence with the aim of making the

UK a more business and innovation-friendly jurisdiction than its larger European neighbours, particularly in the industrial areas which the Government sees as the future.

Trade

A second key objective of the Government's vision of Brexit is rebalancing the UK's trade policy toward "global Britain".

This objective was reflected in the manifesto in a commitment to grow trading ties with Commonwealth countries (with India being specifically called out) and emerging markets. Investors can expect an emphasis from the new Government on concluding new trade deals in this area and promoting both exports to, and attracting inward investment from, those countries. This is also important to the Government as a demonstration of the benefits of driving Brexit forwards, as part of a post-Brexit strategy.

In addition, there is a plan to build 10 Freeports in the UK reinforcing the ambition to grow the UK's role as a trading hub, suggesting potentially significant investment opportunities.

Priority industry sectors

The Conservative manifesto trod a delicate balance.

A clear political priority was to rebalance aspects of the domestic policy agenda toward areas which are perceived to have been neglected since the global financial crisis. This meant demonstrating the Conservatives' commitment to the public services and to the UK beyond a London economy perceived to be dominated by financial services.

For investors this is reflected in the emphasis placed on a number of industries which are explicitly called out as priorities. Over the coming months and years we should expect measures specifically aimed at attracting inward investment into the UK in these sectors and incentives for UK businesses in these sectors to grow their global footprints both through investing globally and growing global partnerships.

Significant weight is placed on science and in particular:

- Life Sciences – with an explicit aspiration to make the UK the leading global hub for this industry
- Technology – in particular computing, robotics, artificial intelligence, design and space.

The Government has committed to a significant step-up in support for scientific investment and R&D accompanied by a statement of intent to unlock long term capital in pension funds for science.

In addition, there is reinforced commitment to support service-based industries in which the UK has been traditionally strong. This includes the creative industries, law and other professional services and financial services (given the emphasis on technology, we can expect a continued championing of the UK's role as a fintech hub).

Beyond these sectors, four other priorities are now likely to create significant investment opportunities:

- a desire to reverse the decline in retail and the "high street" through measures to rebalance the relative position of international online businesses and brick and mortar retailers
- continued emphasis on transport and infrastructure as part of the programme of making the UK an efficient and attractive destination for business
- addressing the "green agenda" through a commitment to grow affordable and clean energy (including committing £1bn to building a network of fast charging points for electric vehicles)
- improving connectivity by significantly increasing the reach of fast broadband by 2025.

Immigration

Brexit will end automatic free movement - the right of EU citizens to come to work in the UK without any form of immigration control.

The new Government is committed to introducing “an Australian style points system” for immigration. Whilst full details have not yet been announced, it is clear from interviews with ministers during the election campaign that the objective is to make immigration from anywhere in the world easier for two core groups of skilled workers: those who are critical to the UK’s public services, including the National Health Service; and those who are likely to drive high-tech, high-skill, innovation-led industry sectors.

The clear intent is to make the UK a more attractive destination for international businesses to establish their European or global hubs in those industries and for international entrepreneurs to establish and build their businesses, taking advantage of the UK’s role as a hub for capital markets and private capital.

Tax

The incoming Government is not planning a radical overhaul of the taxation of large business.

Large business will appreciate this after the significant tax overhauls of the last decade, in particular the major changes to the UK’s rules on the deductibility of interest, reform of the taxation of foreign profits and various cross-border anti-avoidance rules.

There are only two areas of potentially significant change for the taxation of large business:

- the Government plans to press ahead with the introduction of a digital services tax. It is notable that the draft legislation for this new regime purports to tax companies regardless of whether they are based in the UK or not and only targets those businesses with revenues from social media, search engine or online marketplace activities. Whilst those within scope will need to consider very carefully how best to proceed, this is expected to be a relatively limited few. In any event, further changes to the allocation of taxing rights between jurisdictions can be expected in due course in light of the OECD’s ongoing Pillar 1 and Pillar 2 work, which may render the UK’s unilateral introduction of the digital services tax less impactful long term.
- the real estate sector remains the other area where tax changes can still be expected. 2019 saw the introduction of non-resident capital gains tax for direct and indirect disposals of UK land (regardless of whether it is commercial or residential) and April 2020 marks the expected move from income tax to corporation tax for property income earned by non-residents. The Conservatives have also reintroduced plans for a stamp duty land tax surcharge on non-UK resident individuals and companies purchasing residential property in England and Northern Ireland. This had previously been announced by the Theresa May-led Government and later shelved, but is now back with a higher, 3% surcharge above normal rates. Further detail on this will be awaited with interest. Real estate investors have to console themselves with a promised one-year enhancement to the business rates discount for retail businesses and extension of the discount to small music venues, cinemas and pubs, followed by a “fundamental review” of the business rates system.

With corporation tax rates held at 19%, the new Government’s plan is for the UK to continue to have one of the lowest headline rates of corporation tax in the G20 (notwithstanding the U-turn on the previously enacted 17% rate from April 2020). Income tax, NICs and VAT would also not be raised and percentage point increases in both R&D tax credits and the recently-introduced structures and buildings allowances appear aimed at incentivising certain forms of investment.

No withholding tax on dividends and broad exemptions from interest withholding would continue to make outbound profit repatriations straightforward. Implementation of the OECD’s Base Erosion and Profit Shifting reports is also bedding down - one of the benefits of the UK being an early adopter in this regard.

Although a loss of benefits under EU directives post-Brexit would make inbound payments from some jurisdictions less tax efficient, the UK's participation exemptions for both dividends and capital gains and very wide double tax treaty network would ameliorate this significantly.

Entrepreneurs' relief may be reformed, which may imply that the rules will be tightened further. This could be significant for individual investors currently expecting to benefit, but it is hard to argue with the view that the relief probably wasn't a key driver in entrepreneurial activity in the UK.

In short, based on the incoming Government's tax proposals, the UK is very much declaring itself open for business.

Conclusion

The new Government's programme aims to make Britain an attractive base for investors and destination for investment. It aims to promote innovation and supports many of the UK's high-tech and service-based industries through a combination of low taxes, targeted incentives and a supportive regulatory environment. With the retreat of political uncertainty, there are powerful reasons to be optimistic for UK deal activity during 2020. The challenge for business will be understanding where the Government is really keen to deliver, rather than merely campaigning on a point it recognised was important for voters to hear. The investment landscape looks like it is improving, but the need to engage remains as important as ever.

This M&A update is a summary for guidance only and should not be relied on as legal advice in relation to a particular transaction or situation. If you have any questions or would like any additional information regarding this matter, please contact your relationship partner at Hogan Lovells or any of the lawyers listed on the following page of this update.

Contacts

The evolving political and regulatory landscape in the UK will create opportunities for investors and dealmakers who are able to understand and anticipate the impact of that evolution. Hogan Lovells can help to deliver this through its combination of high-end technical capabilities in M&A and deep industry insights informed by exceptional regulatory knowledge.

We draw on the political insight of our experts such as Robert Gardener - a former Civil Servant in the Cabinet Office, Director in the Government of Abu Dhabi, and senior adviser to global corporations, governments and not-for-profit organisations - to help clients develop strategic and practical approaches towards engaging at the heart of public policy making.

For further information speak to one of the contacts below. If you require insight into the issues for a particular industry our contacts below can put you in touch with the relevant expert.

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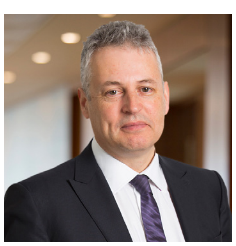

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