Mergers and acquisitions: tax due diligence

Large Corporate OMB

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Careful tax due diligence helps advisers identify, manage and allocate transaction risks, supporting better negotiations, stronger protections and successful post-completion outcomes.

Key Points

What is the issue?

Tax due diligence is a vital stage of any M&A transaction. It helps advisers identify historic tax liabilities, assess their commercial significance and manage risk through transaction structuring, contractual protections and post-completion planning.

What does it mean to me?

Advisers need to look beyond routine compliance and recognise issues across corporation tax, employment taxes, VAT and post-completion planning. Early identification of risks can influence negotiations, purchase price and the protections included in the Sale and Purchase Agreement.

What can I take away?
Effective tax due diligence extends beyond finding technical issues. By identifying risks early, understanding their commercial impact and monitoring post-completion obligations, advisers can help clients avoid unexpected liabilities and achieve more successful transactions.

My first article in this series, ‘Mergers and acquisitions: structuring the deal’ (August 2026), focused on structuring an M&A transaction to achieve the best commercial and tax outcome. Once the broad terms of a deal have been agreed, however, attention turns to the target’s historic tax position and the risks that may be inherited by the purchaser.

This article examines how tax due diligence helps to identify and manage those risks, the contractual protections available to buyers and sellers, and the post-completion issues that advisers should continue to monitor.

Tax due diligence

Tax due diligence is a critical component of the M&A process. It involves a detailed review of the target’s tax affairs to identify historical liabilities, compliance issues and potential risks that could affect the valuation, structure of the transaction or the terms of the Sale and Purchase Agreement (SPA).

Tax due diligence is fundamentally a process of identifying and assessing tax risk. My father spent more than 30 years in the motor trade buying and selling second-hand cars, yet even his experienced eye occasionally let him down, with a newly purchased car breaking down on the journey home.

Due diligence can never eliminate risk entirely, but it should reduce the chances of an unwelcome surprise. A purchaser is being asked to assume responsibility for the target’s historic tax affairs and therefore needs to understand any liabilities, compliance failures or uncertain tax positions before the transaction completes. The objective is not to demonstrate that a business is free from errors, but to identify issues that could affect the valuation, influence negotiations or require protection through the SPA.

This is particularly important given HMRC's penalty regime, where the level of penalties and the time limits for enquiries depend heavily on the taxpayer's behaviour. Minor findings are common, but evidence of deliberate behaviour or fraud, with HMRC able to assess up to 20 years and impose tax-geared penalties, is likely to have a significant impact on the transaction.

Most reviews will consider the key taxes, including corporation tax, VAT and employment taxes, together with any ongoing disputes with HMRC. The aim is to identify historical liabilities, aggressive tax positions or compliance failures that could result in additional costs after completion. Beyond these core areas, the issues that arise will vary considerably depending on the nature and complexity of the target.

For a straightforward owner-managed business, a general tax practitioner may be able to undertake most of the review. More complex transactions, particularly those involving groups, cross-border operations or listed companies, are likely to require specialist input across areas such as international tax, transfer pricing or employment-related securities. Regardless of the size of the transaction, the findings may influence the transaction structure, purchase price or the tax warranties, indemnities and covenants included in the SPA.

Tax issues arising during due diligence

The tax issues identified during due diligence will vary according to the nature of the target and the structure of the transaction. The following examples highlight some of the more significant areas that advisers should consider during the due diligence process.

Corporate tax issues

Corporation tax is likely to be one of the first areas considered during tax due diligence. Alongside confirming that returns have been submitted correctly and liabilities settled, advisers should consider whether there are historic tax risks or planning opportunities that could affect the value or structure of the transaction.

Degrouping charges

Where a company leaves a corporate group within six years of receiving an asset on a no gain, no loss transfer, it is treated as having disposed of and immediately reacquired the asset at its market value at the time of the original transfer. This may give rise to a degrouping charge, effectively bringing the original intra-group transfer into charge as though it had been made to a third party.

This commonly occurs where assets have been rearranged within a group before a disposal, but historic transfers can also create unexpected liabilities if they fall within the six-year window.

Where the disposal qualifies for the substantial shareholding exemption (SSE), the degrouping charge may also be exempt because it is treated as additional consideration for the share disposal. Similarly, HMRC will generally not seek to impose a degrouping charge where a parent disposes of its sole wholly owned subsidiary following an intra-group transfer. Advisers should therefore identify historic intra-group transfers at an early stage so that any potential degrouping charges can be assessed before the transaction structure is finalised.

Property and capital allowances

Where land or buildings are transferred, advisers should establish whether any plant and machinery fixtures qualify for a joint election under Capital Allowances Act 2001 s 198. They should also confirm that the statutory conditions are satisfied, including that expenditure has been pooled, a disposal value has been agreed between the parties and the election is made within the two-year time limit.

It is also important to establish whether the vendor has ever claimed Structures and Buildings Allowance. If so, advisers should identify the qualifying expenditure involved and when the claim was made. These factors may affect the purchaser’s future entitlement and the overall value of the transaction.

Employment taxes

Employment tax compliance should form part of every due diligence exercise. Alongside reviewing PAYE and National Insurance compliance, advisers should consider whether employee incentives and benefits have been operated correctly, as errors can result in unexpected tax liabilities and reporting obligations after completion.

Employment-related securities

Employee share schemes require particular attention. Where share options become exercisable on a sale of the company, any discount on the acquisition of shares will be subject to income tax.

If the shares constitute readily convertible assets, as expected on a whole company sale, both employee’s and employer’s National Insurance contributions also arise on any discount. Depending on the terms of the option agreement, the employee may also be required to pay the employer’s NI. These events can create PAYE reporting requirements for the company.

The company may also be entitled to a corporation tax deduction under Corporation Tax Act 2009 Part 12, based on the difference between the market value of the shares at the date they were acquired, and the consideration given in obtaining them. Where the consideration price includes price adjustment mechanisms linked to the company’s taxable profits or losses, this could potentially have a sizeable impact.

Advisers should also confirm that all employment-related securities (ERS) returns have been submitted to HMRC. Historic grants of options or other reportable events may have been overlooked, particularly where no ERS scheme has been registered with HMRC. This can result in multiple years of outstanding returns together with late filing penalties.

Taxable benefits in kind

Even in larger businesses, taxable benefits can be overlooked. Common examples include owner-managers drawing funds through a director’s loan account during the year and clearing the balance with an annual dividend, without considering whether a beneficial loan charge arises where the balance exceeds £10,000. Similarly, businesses may treat benefits as exempt on the basis that they are trivial benefits or pool cars, when the statutory conditions are not in fact met.

VAT and property taxes

VAT can easily be overlooked during tax due diligence, particularly where a transaction is structured as a share sale. Even where a trade and asset sale is intended to qualify as a transfer of a business as a going concern (TOGC), advisers should not assume the conditions are met. Where only part of a business is transferred, or the purchaser intends to make a further disposal, the availability of TOGC treatment should be considered carefully.

Property transactions require particular attention. Commercial property may be exempt from VAT, but this will not always be the case. Advisers should establish whether the property is less than three years old or subject to an option to tax, as either could result in VAT being chargeable. Where appropriate, it may be possible to revoke an option to tax before completion, removing VAT from the consideration. This may also reduce the purchaser’s stamp duty land tax liability (SDLT), as SDLT would otherwise be payable on the VAT-inclusive purchase price.

Property and other qualifying assets may also fall within the scope of the Capital Goods Scheme (CGS). Where assets remain within the 10-year adjustment period, advisers should establish whether any adjustment arises for the vendor or whether responsibility for future CGS adjustments will transfer to the purchaser as part of a TOGC.

Tax warranties and indemnities

Once tax issues have been identified through due diligence, the parties must decide how they should be addressed. Minor matters, such as an outstanding return, may simply require corrective action before completion. More significant issues, or those involving uncertainty or the exercise of judgement, are more likely to become a matter of risk tolerance and therefore issues for commercial negotiation.

To mitigate such tax risks, contractual protections are commonly included in the SPA. Tax warranties provide assurances about the target’s historic tax compliance, while tax indemnities offer specific protection against identified liabilities. The extent of these protections is ultimately a matter of negotiation between the purchaser and vendor and may have a direct impact on the purchase price.

Although not strictly a tax issue, advisers are often asked to assess the significance of identified risks. That judgement can help determine whether a purchaser is prepared to accept a particular risk, seek additional contractual protection or negotiate a reduction in the consideration.

Post-completion tax issues

Completion does not necessarily bring the tax adviser’s role to an end. Warranties and indemnities will often remain in force for a period after the transaction, while the purchaser’s first tax returns may reveal issues that were not identified during due diligence or have only become apparent once the business is under new ownership.

The first returns prepared following completion are often completed by new personnel or advisers, providing a fresh perspective on the target’s historic tax affairs. Minor errors or more significant issues may therefore come to light after completion.

Where corrective action is required, it will generally fall to the purchaser to amend the relevant returns, although the contractual protections agreed in the SPA may then determine whether any resulting liability can be recovered from the vendor.

Changes to the business

Where a company changes ownership, advisers should also consider the anti-avoidance rules restricting the use of brought-forward trading losses. These may apply where, within five years of a change in ownership, there is a major change in the nature or conduct of the trade.

A major change may include changes to the products or services offered by the business, or to its customers, outlets or markets. Where the rules apply, brought-forward trading losses may no longer be available for offset against future profits, while new losses cannot be carried back to before the change.

Although a purchaser may intend to continue the target’s trade unchanged, post-acquisition developments can trigger the rules unexpectedly. HMRC provides guidance on what constitutes a major change in Statement of Practice 10 (1991), but the test remains subjective. Advisers should therefore consider not only the transaction itself, but also any planned changes to the business after completion where significant trading losses are involved.

Advisers should also consider the wider tax consequences where the target ceases to trade after completion. For example, if a company moves into investment activities rather than continuing to carry on a trade, reliefs that depend on trading status may be affected. This could result in the withdrawal of Enterprise Investment Scheme (EIS) relief or disqualifying events for Enterprise Management Incentive (EMI) options.

Corporation Tax Act 2010 s 459

Most advisers will be familiar with the Corporation Tax Act (CTA) 2010 s 455 charge on loans to participators made by close companies. The related provisions in CTA 2010 s 459 are less familiar, but can create unexpected issues in M&A transactions.

CTA 2010 s 459 is intended to prevent the s 455 charge being avoided through indirect arrangements. Broadly, it applies where a close company provides funds through an intermediary, rather than making a loan directly to a participator.

Although this may appear to have little relevance to an acquisition, the rules can apply in a management buyout. A newly formed holding company may acquire the target before the target company lends funds to its new parent to finance payment to the departing shareholders. HMRC’s view is that this is precisely the type of arrangement CTA 2010 s 459 is intended to catch. Although any charge can usually be avoided by ensuring the loan is settled within nine months of the end of the accounting period, advisers should ensure that the arrangement is identified early and the deadline is not overlooked. Amid the practical demands of completing a management buyout, this can easily become an unexpected post-completion issue.

Other considerations

Although much of the focus during an M&A transaction is on the vendor’s tax position, advisers should not overlook the purchaser’s obligations. Depending on the assets being acquired, stamp duty or SDLT may be payable, with the appropriate returns submitted and tax paid on time.

Successful transactions also depend on effective collaboration between advisers. Tax specialists should work closely with legal advisers to ensure that the agreed transaction structure, contractual protections and wider commercial objectives remain aligned throughout the process.

Finally, buyers will generally want to acquire complete control of the target. Where minority shareholders or option holders remain outside the negotiations, advisers should ensure that appropriate drag-along or tag-along provisions are considered to reduce the risk of the transaction being delayed or frustrated.

Conclusion

Tax due diligence is about far more than identifying historic liabilities. Throughout an M&A transaction, advisers must balance technical tax knowledge with commercial judgement, helping clients identify risks, negotiate appropriate protections and avoid unexpected liabilities after completion.

From the initial structuring of a transaction through to post-completion planning, early advice and careful due diligence can significantly improve both the commercial outcome and the long-term success of the transaction.