TWO POINTS ON HIVE-DOWNS AND SALES

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Introduction

Following enactment of Finance Act 2019, an increasingly common structure for a business looking to divest itself of a trade is the so-called hive-down and sale. Broadly, this consists of incorporating a new company ("Newco") within the same tax group as the seller (typically as a wholly-owned subsidiary), following which the trade is transferred to Newco (the "hive down"). The shares in Newco are then sold to the buyer.

In broad terms, the seller's objective is to avail itself of the relevant intra-group transfer provisions so as to achieve little or no tax leakage on the hive-down. On the sale of the Newco shares, the seller will wish to avail itself of the substantial shareholding exemption ("SSE") so as to relieve itself not only of any chargeable gain arising on disposal of the shares but also chargeable gains and, following enactment of Finance Act 2019, intangible fixed assets de-grouping charges. Where the trade's value is bound up principally in chargeable gains and intangible fixed assets, the overall result of this structure is to allow the seller to divest itself of the trade with minimal corporation tax leakage.

The commercial attractiveness of this structure is obvious. However, it relies on a number of provisions of the tax legislation many of which are subtle and in respect of which careful analysis is required. This article touches on two of them. First, the availability of the SSE on sale of the Newco shares relies on paragraph 15A, Schedule 7AC, Taxation of Chargeable Gains Act 1992 (hereafter referred to simply as "paragraph 15A" and the Taxation of Chargeable Gains act 1992 being referred to as "TCGA 1992") in order to deem the relevant ownership period and trading requirements as being met in respect of Newco. HMRC in their guidance consider that paragraph 15A is not applicable where the seller was a standalone company prior to

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incorporation of Newco. I will argue that this is an incorrect interpretation of paragraph 15A.

Second, there is a commonly-encountered tension between the commercial desire to effect the hive-down at a time when there is certainty that Newco will be sold to the buyer, and the tax requirement that the hive-down is as between members of a tax group. I will discuss one possible solution to this tension, but highlight that it applies only to hive down of chargeable gains assets and not, for example, intangible fixed assets.

But before discussing these issues further it will be helpful to sketch out the structure in a little more detail.

Hive-downs and sales

The structure comprises three steps. First, incorporation of Newco within the seller's tax group. Second, the hive-down of the trade from the seller to Newco. Third, the sale of Newco to the buyer.

The first step is unremarkable from a tax perspective. As regards the second step, from a direct tax perspective this should be a "no gain / no loss" intra-group transfer of chargeable gains assets to Newco. Broadly comparable provisions should apply to intangible fixed assets (on which see further below). Trading losses and capital allowances pools relating to the trade should, roughly speaking, transfer to Newco automatically. From an indirect tax perspective, provided the relevant conditions are met the hive down should be a transfer of a going concern and hence outside the scope of VAT. Stamp duty and stamp duty land tax, however, would be triggered insofar as there would be arrangements in place for the buyer to obtain control of Newco but not the seller.

The third step relies on the SSE to relieve not only any chargeable gain arising on disposal of the Newco shares itself, but also any chargeable gains and intangible fixed asset de-grouping charges arising as a consequence of that sale. The latter is possible by virtue of the fact that the amount of any chargeable gains de-grouping charge is deemed to be added to the proceeds received by the seller under the provisions of section 179(3D) TCGA 1992. In respect of any intangible fixed asset de-grouping charge, Finance Act 2019 inserted a new section 782A into Corporation Tax Act 2009 which provides that no de-grouping charge arises where the SSE is available in respect of the sale of the Newco shares.

It is, of course, a requirement of the SSE provisions that the seller must have held a substantial shareholding in Newco throughout a twelve-month period beginning not more than six years before the day on which the Newco shares are disposed of (the "substantial shareholding requirement"). In addition, Newco must have been a trading company or the holding company of a trading group or subgroup throughout the latest twelve-month period by reference to which the substantial shareholding requirement was met (the "trading company" requirement). It is clear that neither of these requirements would be met where, as is typical, Newco is incorporated shortly before step two. However, reliance can be placed on paragraph 15A, Schedule 7AC, TCGA 1992 in order to deem the substantial shareholding requirement to be met where, broadly, trading assets were transferred into Newco within a chargeable gains group, which is precisely what the second step achieves. In turn, this deems the trading company requirement to be met under the provisions of paragraph 19(2A), Schedule 7AC, TCGA 1992.

Paragraph 15A

It is apparent from the summary of the structure above that paragraph 15A is key to ensuring that SSE is available to relieve chargeable gains and intangible fixed assets de-grouping charges. It is worth reproducing paragraph 15A in full:

> *15A*
>
> *(1) For the purposes of this Part, the period for which the investing company is treated as holding a substantial shareholding in the company invested in is extended in accordance with sub-paragraph (3) if the following conditions are met.*
>
> *(2) The conditions are—*
>
> > *(a) that, immediately before the disposal, the investing company holds a substantial shareholding in the company invested in,*
> >
> > *(b) that an asset which, at the time of the disposal, is being used for the purposes of a trade carried on by the company invested in was transferred to it by the investing company or another company,*
> >
> > *(c) that, at the time of the transfer of the asset, the company invested in, the investing company and, if different, the company which transferred the asset were all members of the same group, and*
> >
> > *(d) that the asset was previously used by a member of the group (other than the company invested in) for the purposes of a trade carried on by that member at a time when it was such a member.*
>
> *(2A) For the purposes of sub-paragraph (2)(b) and (d), "trade" includes oil and gas exploration and appraisal.*
>
> *(3) The investing company is to be treated as having held the substantial shareholding at any time during the final 12 month period when the*

asset was used as mentioned in sub-paragraph (2)(d) (if it did not hold a substantial shareholding at that time).

(4) *"The final 12 month period" means the period of 12 months ending with the time of the disposal.*

HMRC provide guidance on this provision at chapter 53080c of the Capital Gains Manual. The relevant extract reads as follows:

> *Note that paragraph 15A extends the holding period by reference to the previous use of trading assets by a member of the group while it was a member of a group. Therefore a capital gains group must have existed at the time. The provision cannot apply where the transferee company is a newly acquired subsidiary of what was previously a single trading company.*

In my view this guidance wrongly construes the legislation. Looking at sub-paragraph (d) of paragraph 15A ("sub-paragraph (d)"), the key word is "the" before "group". In context, "the" group can only refer to the group described in sub-paragraph (c) of that paragraph. Assuming that there is no separate company which transferred the asset to Newco (i.e. the "investing company" transferred the asset to the company "invested in"), that group clearly includes Newco. The "investing company" and the "company invested in" are together sufficient to form "the" group which sub-paragraph (d) refers to. However, HMRC's guidance refers to "a" group, which does not accurately reflect the legislation. It is not the case that sub-paragraph (d) requires the seller to have formed part of "a" group before Newco is incorporated.

Other commentators (see e.g. *Ignorance or apathy* in *Taxation* 12 March 2015) have read the words in brackets in sub-paragraph (d) to operate so as to exclude the "company invested" in from the group. However, this is not a natural reading of those words on account of the fact that sub-paragraph (d) relates to use of the asset by a specific company, as opposed to providing a definition of a specific group. On a natural reading, those words qualify the words "a member" as opposed to "the group". If the words in brackets were intended to qualify "the group", then the draftsman would presumably have made that more explicit, e.g. "(such group not including the company invested in)".

My interpretation of sub-paragraph (d) is further supported by the fact that the alternative interpretation results in an absurd outcome. It would be possible to fall within HMRC's interpretation of sub-paragraph (d) by incorporating another subsidiary of the seller company at least 12 months prior to the main hive-down and sale transaction. It would be perfectly permissible to leave this company dormant, but would have the result of ensuring the seller is not a standalone company. This is an odd result, as the subsidiary would serve no economic purpose and, on the assumption that it has no chargeable gains, allowable losses or other tax liabilities, it would not be within the charge to corporation tax (see *Walker v Centaur Clothes* [2000] STC

324). The existence of the subsidiary would not result in any benefit or disbenefit to either the exchequer or the taxpayer other than ensuring sub-paragraph (d) is met.

It may be argued in reply that HMRC's interpretation is aimed at preventing the mischief of allowing a standalone company to hive down a trade into a new subsidiary, and then selling the subsidiary off to a third-party buyer with SSE relieving any chargeable gains and intangible fixed asset de-grouping charges. This argument can be seen to be weak when one considers a case where the seller company happened to have held dormant subsidiaries for at least 12 months prior to the hive-down and sale. Assume that the dormant subsidiaries are economically inactive, and have no chargeable gains, allowable losses or other tax liabilities such that they are not within the charge to corporation tax (see *Walker v Centaur Clothes* [2000] STC 324); it would not make sense to say that the mere existence of those subsidiaries, which are effectively economic and tax "nothings", should have a material impact on the availability of SSE for the seller company.

The application of the so-called "golden rule" of statutory interpretation tells against HMRC's interpretation of sub-paragraph (d). While a detailed survey of the "golden rule" is beyond the scope of this article, it is possible to distil certain key principles from the case law (e.g. *River Wear Commissioners v Adamson* (1877) 2 App. Cases 743 and *Vacher & Sons Ltd. v London Society of Compositors* [1913] AC 107):

1. When interpreting a legislative provision, the Courts should apply the plain English meaning of the words used in the provision – even if that results in an unjust or unwise result.
2. However, if the words used admit of two interpretations one of which leads to an absurdity, then the Courts should favour the interpretation which does not lead to that absurdity.
3. There is no clear definition of an "absurdity" for these purposes, but it does not mean unwise or even acts that are dangerous to the community.

Applying these principles to the current case my principal argument is that, applying the plain English meaning to the words in sub-paragraph (d), in my view the meaning is clear and as I have set out above. However, even if HMRC disagree with my interpretation, at the very least this must show that the words admit of two interpretations. However, HMRC's interpretation, for the reasons set out above, in my view produces an absurd result.

For these reasons, my conclusion is that HMRC's interpretation of sub-paragraph (d) is not the correct interpretation. Instead, sub-paragraph (d) should be interpreted so that it can apply where the transferee company is a newly incorporated subsidiary of what was previously a standalone company.

Ensuring the Hive-Down is Intra-Group: A Commercial Tension

To ensure no corporation tax arises on the hive-down, it is essential that the seller and Newco form a group for the relevant tax purpose. This article will focus on chargeable gains and intangible fixed asset groups only, where the definitions are contained in section 171 TCGA 1992 and 764 *et seq.* Corporation Tax Act 2009 respectively. I do not propose to discuss these definitions in detail beyond noting that Newco would form a group with the seller on account of the seller beneficially owning at least 75% of the ordinary share capital of Newco. The legislation expressly states that "beneficial ownership" is relevant for these purposes (see section 170(2)(b) TCGA 1992 and section 773 Corporation Tax Act 2009, both cross-referring to section 1154(6) Corporation Tax Act 2010).

It is well-established that an unconditional contract providing for the sale of shares in company A by company B to company C results in company B losing beneficial ownership over those shares (see *J Sainsbury plc v O'Connor (H M Inspector of Taxes)* 64 TC 208, affirming *Wood Preservation Ltd. v Prior* [1969] 1 WLR 1077). This has practical significance in that, as a commercial matter, the seller will prefer to hive-down the trade to Newco only once it has "deal certainty" that the buyer will acquire Newco, which in many cases means effecting the hive down after an unconditional contract for sale of Newco's shares (such contract, whether or not conditional, being the "SPA") has been entered into with the buyer. There are many reasons for this, but a common concern is that transferring employees around unnecessarily within a group can be unpopular with the employees concerned.

As against that, in order to preserve the group relationship it is necessary to effect the hive down *before* the unconditional SPA has been entered into. This gives rise to a commercial tension. One solution is to rely on the provisions of section 28, TCGA 1992 "section 28", which reads as follows:

> *28 Time of disposal and acquisition where asset disposed of under contract*
>
> *(1) Subject to section 22(2), and subsection (2) below, where an asset is disposed of and acquired under a contract the time at which the disposal and acquisition is made is the time the contract is made (and not, if different, the time at which the asset is conveyed or transferred).*
>
> *(2) If the contract is conditional (and in particular if it is conditional on the exercise of an option) the time at which the disposal and acquisition is made is the time when the condition is satisfied*

The solution is to enter into an unconditional contract for the hive-down of the trade to Newco (such contract, whether or not conditional, being the "BTA") prior to entry into the unconditional contract for the sale of Newco's shares to the buyer. However, the title to the assets that make up the trade need not be transferred to Newco. The argument is that, on application of sub-section 1, the date of disposal of the chargeable gains assets that comprise part of the trade is fixed at the date of the hive-down contract, which precedes the date of disposal of Newco's shares that is similarly fixed on operation of sub-section 1. This should achieve the right tax result (i.e. an intra-group transfer) without necessitating the actual transfer of any assets to Newco.

It is worth emphasising that section 28 does nothing more than fix the time of disposal. It does not create a separate rule about what constitutes a disposal per se. This is established in *Jerome v Kelly* [2004] STC 887, a House of Lords case in which Robert Venables QC appeared for the taxpayer. It concerned the predecessor to section 28, section 27, Capital Gains Tax Act 1979, and in the words of Lord Hoffman:

> *[Section 27, Capital Gains Tax Act 1979] does not deem the contract to have been the disposal as the 1962 Act had done. For that reason, it includes no provisions dealing with what happens if the contract goes off. In such a case, there will be no disposal and nothing to deem to have happened at the time of the contract. The time of the contract is deemed to be the time of disposal only if there actually is a disposal.*

The impact is that the trade must actually be disposed of to Newco (i.e. the BTA must actually be completed) so that the timing rule in section 28 can take effect. In practice, this will always happen as the buyer will not purchase Newco's shares unless and until Newco holds the trade. Conversely, if the deal falls through so that the SPA is not entered into, entry into the BTA will not have triggered an actual disposal of the trade and the timing rule in section 28 will not come into play.

There is some elegance to this solution, but the problem with it is that it only purports to address the position regarding chargeable gains assets. It does not address other assets such as intangible fixed assets. I cannot find any specific statutory provision in the intangibles code which operates in an equivalent way to section 28. The only conclusion that can be drawn from that is that the selling company must retain beneficial ownership over Newco's share at the "time of transfer" for the purposes of the intangibles intra-group transfer provisions in section 775, Corporation Tax Act 2009. The time of transfer can only be the date of actual transfer, i.e. the date on which title to the intangibles passes to Newco

There is a curious asymmetry here. As Lord Hoffman sets out in his judgment in *Jerome v Kelly* (see paragraphs 8 to 11 therein), section 28's predecessor was introduced into the capital gains tax legislation in Finance Act 1971 at the same time as the abolition of "Case VII" income tax on short-term gains that had been introduced by Finance Act 1962. As Lord Hoffman says:

> *[11] It is hard to see why the abolition of Case VII (which needed a provision to fix the time of the acquisition and disposal) should have made it necessary to introduce one for the capital gains tax, which*

> *did not depend on the time of disposal. The rules for the two taxes are quite distinct.*

It is therefore perhaps best to see section 28 to be specific to the context in which it was initially introduced, possibly reflecting a confusion on the part of the draftsman in relation to the purpose of section 28's predecessor in the relevant income tax rules.

On that basis it may be that the framers of the intangibles legislation deliberately chose not to include an equivalent provision in the 2002 re-write of that legislation.