

Hive downs (Lecture B1379 – 19.07 minutes)

Introduction

Sometimes a group may need to move trades around between companies in order to be able to deal with a transaction, such as a reorganisation or moving the trade into a new company prior to sale.

The legislation enables transfers to be done on a fairly benign basis for tax purposes but there are several issues that need to be considered, such as:

- Trade losses;
- Chargeable gains;
- Intangible assets;
- Inventory;
- Capital allowances.

Trade losses – s940A CTA 2010

The transfer of trade from one company to another is a cessation for the transferor. Normally any trade losses not able to be relieved by terminal loss relief would be forfeited.

However, when transferred between companies under common ownership, the losses can be transferred to the transferee company.

Common ownership means that least 75% ownership by same persons at any time within two years after the transfer. This is not an onerous condition.

This does not just apply in group situations. It would apply, for example, where an individual owns 75%+ of Company A and Company B. If the trade is transferred from A to B, losses carried forward can be preserved within B.

Succession

The transferee must be a successor to the business activities of the predecessor.

This may seem quite straightforward but there can be issues as illustrated by three leading cases.

In *Rolls Royce Motors Ltd (RRML) v Bamford* [1976] 51 TC 319, the company succeeded to the activities of two out of six divisions of Rolls Royce Ltd which collapsed in 1971.

The other four divisions of Rolls Royce Ltd including the Aero Engine (Derby) Division, by far the largest of the six, had been transferred to Rolls Royce (1971) Ltd, a government-owned company.

The special commissioners held that the relative scales of the activities carried on by RRML and by Rolls Royce Ltd were decisive in determining that they carried on different trades.

The trade of Rolls Royce Ltd consisted of all the activities of its six divisions, which supported the commissioners' decision.

In *Falmer Jeans Ltd (FJ) v Rodin (HMIT)* [1990] BTC 193, a marketing company taking over the manufacturing activities of another member of the same group, which had previously made-up garments using cloth provided by the marketing company for a fee, succeeded to the trade of the manufacturing company.

FJ was a subsidiary of Falmer International Ltd (FIL). It sold clothing through a mix of wholesale and retail outlets.

Before 1984 all the clothing sold by FJ was manufactured by others, either bought in from unconnected sources or manufactured by FMS another subsidiary of FIL. The sole function of FMS was the manufacture of garments. FMS was FJ's principal supplier.

FMS bought the sewing cotton, buttons, etc. which it required from third parties but the cloth was supplied by FJ. FMS's services were charged to FJ on the basis of cost plus a commercial margin.

FMS had made losses over a number of years and ceased trading on 31 December 1983. On 1 January 1984, FJ took over FMS's assets and carried on the manufacturing activities in its own name, thus carrying on a single trade of manufacturing and selling clothing but the costs attributable to the manufacturing trade previously carried on by FMS were separately identified in FJ's accounts.

To carry forward losses, the successor is required to carry on the same trade as the predecessor, not just its activities. It is not a requirement that the successor carry on the whole trade of the predecessor, but it must carry on enough of its activities so that it could be said that the same trade was carried on. There is no requirement that the successor carry on the predecessor's trade as a separate trade but if that trade was carried on as a single trade with that of the successor, the successor was to be treated as carrying on a single trade.

Where the successor only carries on part of the predecessor's trade or the successor inheriting the predecessor's trade and running it alongside its own trade, revenue and expenses need to be apportioned.

This demonstrates that the 'succession to trade' can be satisfied even though the trading activities in question are no longer generating revenue directly or are charged for separately but are absorbed into a single trade in which the profits were earned without distinguishing which part of the trade made them.

When FJ succeeded to FMS' trade, FMS no longer made-up FJ's material to specification and no separate charge was made for manufacturing services. However, the manufacturing activities were still conducted for reward and profit was earned by selling the finished articles. Both changes were a direct consequence of the acquisition of FMS's trade by FJ.

The legislation focuses on the trading activities rather than the trade, by treating those activities as if they were a separate trade and apportioning part of the successor's revenues and expenses to those activities.

FJ began to carry on all the activities carried on by FMS. The only difference after the succession was that no separate charge was made for the manufacturing services (because the activities all took place within a single company).

FJ's appeal against the refusal of the Inspector to allow FMS' trading losses to be carried forward was allowed.

In *Barkers of Malton Ltd (BOML) v R & C Commrs (2008) SpC689*, the special commissioners found that ownership of the assets of the trade was not of itself enough to constitute carrying on the trade, there has to be evidence that the successor actually carried on the trade transferred.

The trade of Haws Garage Limited (HGL) was transferred to its subsidiary, Haws of York Ltd (HYL), as part of a larger reorganisation, to enable the trade, and the land and buildings from which the trade was carried on, to be sold to different third parties.

HYL only owned the trade for 90 minutes, but BOML argued that HYL carried on the trade during this time on the basis that the legislation did not require the trading to take any particular form, or to be of specific duration, and that HGL had acted as the agents of HYL in carrying on the trade on its behalf.

The special commissioners decided that the very short period of ownership, the lack of evidence to demonstrate that HGL had acted as an agent for HYL, and the fact that HYL undertook no trading activity itself meant that HYL did not carry on the trade. As such, the trading losses of HGL could not be transferred to HYL when the assets and trade of HGL were transferred. This would mean that the buyer of HYL would not be able to indirectly benefit from the losses.

Loss carry forward in successor company

If loss arose before pre-1 April 2017 it can only be offset against future profits of the trade that was transferred. This issue can be avoided by transferring a profitable trade to a loss-making company with the same trade in the same 75% group, where this is commercially possible.

To the extent that they are post-1 April 2017 losses, there is no restriction on use against the total future profits of the successor.

Relevant liabilities restriction

If the liabilities retained by the transferor company exceeds the assets retained plus any consideration for the transfer, losses have to be restricted.

Losses available = $R - (L - A)$

R = unutilised loss

A = assets not transferred to successor + consideration for transfer

L = liabilities not transferred to successor

Example - Transfer of trade from Pink Ltd to Orange Ltd

Pink transfers assets of £500,000 and liabilities of £400,000 but retains assets of £600,000 and liabilities of £1,000,000.

Orange pays Pink £100,000 for the net assets transferred.

Pink had accumulated losses of £750,000.

How much trading loss can Orange receive from Pink on the transfer of the trade?

$$R = 750,000$$

$$A = (600+100) \text{ £}700,000$$

$$L = \text{£}1,000,000$$

Losses transferred with trade $(750,000 - [1,000,000 - 700,000]) = \text{£}450,000$

Capital allowances

Where the predecessor and successor are connected with each other and both are within the charge to UK tax, can jointly elect to transfer pooled assets at tax WDV., thus avoiding a balancing adjustment for the transferor.

Connected means one controls the other, or both controlled by the same person. This is not a 75% test unlike for losses.

If the transfer takes place part way through accounting period then simply pro-rate the WDA for the transferor and transferee.

Stock/inventory

Normally inventory on hand at cessation of trade is valued at market value. This can give rise to a trading profit on cessation if the market value is higher than carrying value.

An election can be made (s.167 CTA 2009) if transferred to a connected person for a different value to be used.

S.167 CTA 2009: Where the market value exceeds both:

- the actual price agreed between the parties and
- the original cost,

the parties can elect to value the inventory at the greater of these two values.

Example

A Ltd owns 100% of B Ltd and wishes to hive down the trade to Newco, pending a sale to a third party.

B Ltd owns inventory which cost £240,600 and has a market value of £300,000.

It will be transferred to Newco at an agreed value of £200,000.

What is the value of the inventory transferred for tax purposes?

If no election is made, the inventory is transferred at its market value of £300,000. This would give rise to a trading profit in B Ltd of $(300,000 - 240,600) \text{ £}59,400$.

B Ltd and Newco can jointly elect under s.167 CTA 2009 for the inventory to have a tax value of the higher of:

Original cost £240,600, or

Agreed transaction price £200,000.

i.e. £240,600

This avoids a profit arising on the transfer, and Newco is treated as having paid £240,600 for the inventory when it sells it.

Chargeable assets and intangible assets

Chargeable assets transferred between 75% group companies take place for tax purposes at a price that gives no gain/no loss.

The successor takes over the base cost of the predecessor (with indexation to December 2017 if the asset was acquired before this date by the predecessor).

If successor company leaves the group within 6 years of receiving the asset there may be a de-grouping gain chargeable (covered in session on selling companies out of a group following a hive down).

Intangible assets are transferred between 75% group companies at tax written down value so that no profit or loss arises for the transferor. The successor may be subject to a de-grouping profit or loss if it leaves the group within 6 years of receiving the intangible asset (covered in session on selling companies out of a group following a hive down)

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