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2

Buying a Company

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Introduction to buying a company

[2.1] A company takeover is an occasion with many tax planning opportunities and at the same time there are quite a few tax pitfalls to avoid. It is an event with short, medium and long-term consequences. It represents either a venture into a new business or the expansion of an existing business. Such a step needs to be thoroughly thought out from as many points of view as possible. Tax is a major but by no means the only factor to be considered.

The impact of taxation for the purchaser is, for instance, immediate in the case of stamp duty and ongoing in relation to the timing and amount of tax payable on gains when the assets within the target company are sold. Past liabilities and losses are also relevant, eg in relation to unsettled claims, roll-over relief, losses carried forward and intra-group transfers. Tax affects the value to be placed on the target, and is therefore at the very heart of the transaction itself.

There is usually a balance to be struck between the desired commercial consequences of a purchase and the ideal tax structure. The value to be placed on certain assets or liabilities may well influence the negotiations on price and the wording of warranties on tax will usually influence the form in which the purchaser structures the vehicle which makes the acquisition and its financing. Tax advice can also have a significant effect on the form of the transaction between vendor and purchaser and this is where the advice may be most useful.

Other factors which will affect the purchaser's decisions include the form of commercial structure required by the financiers of the transaction, the vendor's requirements as to what he is prepared to sell and in what form, and employment law.

This chapter does not cover advice on stamp duty or stamp duty land tax. For further information on the latter please refer to **CHAPTER 55 STAMP DUTY LAND TAX**.

This chapter is written with the position of the purchaser in mind, although various considerations which are important to the vendor are also mentioned. **CHAPTER 53 SELLING A COMPANY** is written with the position of a vendor to the fore.

The current tax climate for corporate acquisitions

[2.2] There is a general awareness in the business community that since the 1970s HMRC has attempted to clamp down on tax avoidance. This led to a

series of decisions by the House of Lords which have had a profound impact on tax planning, eg *Ramsay (WT) Ltd v CIR* 54 TC 101 and *Furniss v Dawson* 55 TC 324. The cases have been concerned with whether there has been a pre-ordained series of transactions (sometimes referred to as a 'single composite transaction') and whether there are steps in the series which have no commercial purpose apart from avoiding tax.

In a New Zealand case, *IRC v Challenge Corp Ltd* [1986] STC 548, Lord Templeman introduced the distinction between tax mitigation (legitimate) and tax avoidance (illegitimate). He said that: 'Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his . . . tax liability'. He went on to contrast tax avoidance: 'Income tax is avoided and a tax advantage is derived from an arrangement when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had'. Lord Templeman succeeded in bringing this formulation into English law (*Ensign Tankers (Leasing) Ltd v Stokes* 64 TC at 740 (HL)) without apparent dissension from the other Law Lords. The House of Lords (Lord Goff dissenting) found that the taxpayer could be (and in that case was) one of the venturers in the trade in which it invested in order to obtain its tax saving, notwithstanding the expressed tax avoidance motive. The House also held that, since there was a true trading venture, the taxpayer could not be denied the deduction of an amount equal to its real investment.

Composite transactions, or preordained series of transactions, with steps which have been included only for the avoidance of tax may be treated for tax purposes as if those steps had not been included. However, the judgment of Knox J in *Pigott v Staines Investments Co Ltd* 68 TC 342 illustrates the reluctance of the courts to recharacterise 'a perfectly normal and straightforward commercial transaction into a thoroughly abnormal and unusual transaction whose only merit (if that is the right word) is that it attracts a tax disadvantage'. After a period when practitioners' concerns about the scope of the *Ramsay* decision had receded, the House of Lords decision in *IRC v McGuckian* 69 TC 1 reopened the discussion about the scope of the *Ramsay* principle. In particular, the 'purposive' approach found favour with the House of Lords whereby, in determining the natural meaning of particular expressions in their context, weight is given to the purpose and spirit of the legislation (Lord Cooke at 84). Lord Steyn, in commenting on the decisions in *Ramsay* and *Craven (Inspector of Taxes) v White* [1989] AC 398, [1988] 3 All ER 495, HL, indicated that the rule of statutory construction as set out in *Ramsay* is not based upon a linguistic analysis of the meaning of particular words in the statute. It was founded on a broad purposive interpretation, giving effect to the intention of Parliament. In *MacNiven v Westmoreland Investments Ltd* [1998] 73 TC 1, the House of Lords reviewed again the limits of the *Ramsay* approach. It confirmed the purposive approach set out in *McGuckian*, but held that one could not disregard a transaction which came within statutory language simply on the grounds that it was entered into solely for tax reasons. Lord Hutton expressed the view that an essential element of a transaction to which *Ramsay* applied was that it should be artificial, distinguishing between

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'a real gain (or loss) and a contrived and unrealistic gain (or loss)'. However, this did not form part of the decision of the majority.

There have been further developments in case law on tax avoidance at the European Court of Justice ('ECJ'). One of the most notable is a VAT case, *Halifax* (Case C-255/02, [2006] STC 919) where the ECJ decided that a supply of goods or services was still a 'supply' for VAT purposes even though it had been carried out solely to obtain a tax advantage. However, the Court also held that Community law could not be relied upon for abusive ends. The Court defined 'abuse' as involving the obtaining of a tax advantage contrary to the purpose of the relevant provisions in circumstances where it was objectively apparent that the essential aim of the transaction was to obtain a tax advantage. In the *Halifax* case itself, the right to deduct input tax was denied on the basis that the sole purpose of the transactions was to obtain a tax advantage and they were therefore characterised as 'abusive'.

The case of *Schofield v Revenue and Customs Comrs* [2010] UKFTT 196 (TC), [2010] SFTD 772 involved planning with gilts to generate, very broadly, a non-taxable profit and an allowable loss. HMRC denied relief for the loss. On appeal the Tribunal found for HMRC and decided that the principle established in *Ramsay* should apply, and also that the concept of a single composite transaction, as in *Furniss v Dawson*, was appropriate. Conversely, in the case of *Mayes v HM Revenue and Customs Comrs* [2009] EWHC 2443 (Ch), [2010] STC 1 the courts, albeit with stated reluctance, allowed a claim for losses on non-qualifying life insurance policies.

The principle of 'abuse' is part of EC law and Member States must operate their laws on taxation in a way that is consistent with Community law. A further case in this area, *Cadbury Schweppes* (Case C-196/04, [2007] Ch 30), held that the UK's controlled foreign company legislation had to be able to be justified on the ground of prevention of abusive practices, ie the specific objective must be 'to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on profits generated by activities carried out on national territory'. The ECJ held, in this instance, that for arrangements to be artificial it was not enough to show the existence of tax-saving motives; the test would not be met if the company was actually established in a host Member State and was carrying on a genuine economic activity. It may be, therefore, that a genuine economic activity is outside the scope of the 'abuse' principle.

The UK's general anti-abuse rule ('GAAR') was introduced in the Finance Act 2013 with effect for transactions after 16 July 2013. For the GAAR to apply to an arrangement it has to fail the double reasonableness test:

- Is it reasonable to conclude that the obtaining of a tax advantage was the main purpose or one of the main purposes of the arrangement?
- Can the entering into or carrying out of the arrangement reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions?

HMRC has issued guidance on the GAAR, which can be found at www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules. In addi-

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tion from 15 September 2016 a penalty of 60% of tax due will be charged on any tax arising from HMRC successfully applying GAAR.

It is now usual for new legislation to contain an anti-avoidance clause. Such clauses are often worded in very general terms and may create uncertainty as to their practical scope.

For example, TCGA 1992, s 16A is essentially a GAAR on capital losses.

A similarly structured amendment in CTA 2009, s 1220 restricts relief on management expenses in investment companies.

The Finance Act 2013 introduced three targeted anti-abuse rules (TAARs) in relation to loss buying, covering capital allowances, deductions and profit transfers.

Briefly, for any of the three TAARs to apply, there must be a 'qualifying change' as defined in CAA 2001, Part 2, Chapter 16A. CAA 2001, s 212C provides that there is a qualifying change where one or more of four Conditions A to D are met:

- Condition A is met where there is a change of ownership;
- Condition B is met where a Consortium Principal Company ownership proportion is greater at the end of any day than it was at the beginning;
- Condition C is met where the company ceases to carry on a trade (in whole or in part) and that trade is then carried on in partnership by two or more companies and CTA 2010, Part 22, Chapter 1 applies; or
- Condition D is met where at the beginning of a day the trade is carried on in partnership and the company's share in the trade at the end of that day is less than it was at the beginning.

The Capital Allowances TAAR

[2.3] The Capital Allowances TAAR extends CAA 2001, Chapter 16A, Part 2 such that it now also applies where:

- tax written down value ('TWDV') exceeds balance sheet value ('BSV') by £50 million or more; or
- TWDV exceeds BSV by £2 million or more and the benefit conferred by the capital allowances is not insignificant in the context of the total benefits derived from the transaction; or
- TWDV exceeds BSV by less than £2 million and a main purpose of the qualifying change was to obtain a reduction in profits, or an increase in losses, in consequence of a claim for capital allowances.

Chapter 16A operates by allocating the excess of TWDV over BSV to a new pool. The capital allowances arising from this pool may be used only to reduce the same profits that they could have reduced had the qualifying change not taken place.

The Deduction and Profit Transfer TAARs

[2.4] The Deduction and Profit Transfer TAARs are set out in CTA 2010, Part 14A.

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The Deduction Transfer TAAR prevents losses arising from deductions which can be regarded as highly likely to arise after a qualifying change from being surrendered as group relief or set against total profits where claiming relief for such deductions was a main purpose of arrangements connected to the qualifying change. Deductions include trading expenses, property expenses, management expenses and non-trading loan relationship debits. The TAAR does not affect any claims, for example, for trading losses carried forward against subsequent profits of the same trade.

The Profit Transfer TAAR prevents profits being transferred to a company with a qualifying change where a main purpose of the transfer is to utilise deductions available to that company. This TAAR denies relief for deductions claimed in any accounting period ending on or after the change.

A different approach was signalled by the disclosure regime introduced in the Finance Act 2004 and extended further subsequently. This provides for disclosure of tax avoidance schemes defining persons required to make disclosure and imposing penalties for non-compliance. For a full discussion of tax avoidance, see **Chapter 51 Ramsay and Tax Planning**.

Structural approach to tax on an acquisition

[2.5] The immediate tax cost for the purchaser of shares will normally be relatively small, namely stamp duty or stamp duty reserve tax. It is necessary, therefore, to look at the transaction from several aspects:

(a) pre-acquisition tax planning:
  - (i) assets or shares;
  - (ii) if assets, should it be assets alone or a trade transferred as a going concern;
  - (iii) if shares, should they be shares in a company with its existing business or a company with a hived-down or reorganised business;
  - (iv) having the right ownership going forward;

(b) dealing with the historic position – ie warranties and indemnities;

(c) taxes on the transaction itself;

(d) tax after the transaction:
  - (i) tax aspects relating to the future;
  - (ii) tax aspects relating to the past. These will include losses, group relief, and intra-group transfers of assets; and

(e) the impact on existing or future venture capital investments as the age of and funds raised by the target have to be taken into account.

Comparison and contrast with the acquisition of a business

[2.6] For most of this chapter it is assumed that the parties have agreed to the sale and purchase of a company. However, as an alternative, the deal may be structured as a purchase of assets or of a business as a going concern.

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Advantages of buying assets or a business

[2.7] There can be many advantages to a purchaser in buying the undertaking and assets of a company rather than the company itself. They include the following.

(a) Following the F (No 2) A 2015 the purchaser may obtain relief from corporation tax on the cost of intangible assets that are not customer related, as these are amortised or subject to impairment review in the accounts (or by election at 4% pa). The Finance Act 2015 prevents any such relief where the acquisition is made from a connected unincorporated business. However, the amortisation of goodwill acquired may be deductible when the goodwill is acquired on or after 1 April 2019 as part of a business acquisition with eligible IP assets and the goodwill is neither a 'pre-FA 2019' relevant asset nor acquired as part of a business incorporation.

(b) The purchaser may obtain capital gains roll-over relief on the acquisition of qualifying assets (eg land and buildings, fixed plant, ships, aircraft, milk quotas, ewe and suckler cow premium quotas, fish quota, various farmer payment entitlements, various rights of a Lloyd's member, satellites, space stations and spacecraft).

(c) The purchaser should be entitled to capital allowances on plant, machinery, etc acquired, although where the assets are fixtures in a property relief is restricted to the amount agreed between the parties and may, in any case, not exceed the amount claimed by the seller under CAA 2001, ss 185 and 62. Generally the easiest way to make the claim is for the purchaser and the seller to enter into an election under CAA 2001, s 198. If an agreement cannot be reached the matter has to go before the Tribunal. From 29 October 2018, in some instances the Structure and Building Allowance may be available on property acquisitions.

(d) The purchaser may obtain roll-over relief on credits from the disposal of intangible assets against new expenditure on intangible assets. The legislation additionally provides for roll-over relief on underlying assets where a company is acquired.

(e) The base cost for capital gains tax purposes for the purchaser of any assets acquired directly is likely to be different from their capital gains tax base value in the target company. The purchase of the assets at current market values may reduce tax on the capital gain realised by the purchaser in due course.

(f) The cost of any trading stock acquired will be a deduction for corporation tax purposes in the purchaser's business, in the period in which it is disposed of or written down. There is often flexibility over the transfer value of stock, which can increase the value of the deal, depending upon the tax position of each party.

(g) The purchaser will avoid taking on the continuing liabilities of the target company's business, eg past tax liabilities or commercial claims. This can be especially important where the vendor's ability to meet warranty and indemnity claims is uncertain.

(h) The purchase of a company can bring with it VAT risks if the target is a member of a VAT group, because such members carry joint and several liability for all the VAT payable by the group.

Disadvantages of buying assets or a business

[2.8] There may, however, also be disadvantages for the purchaser in proceeding along this route. These would include the following.

(a) Where real estate is being acquired, stamp duty land tax ('SDLT') may be greater than the duty on a share purchase.
(b) The commercial consequences of acquiring a business may be more complex, for instance:
  (i) continuing contracts with third parties will need to be novated, that is, the benefit of and the obligations under the contract need to be legally transferred to the purchaser; and
  (ii) the purchaser would have to take on the employees of the business directly rather than continuing with them as employees of their original employer. This may cause difficulties, especially where the employment terms of the purchaser differ significantly from those of the vendor.
(c) The vendor may well resist a sale of assets because of the extra tier of taxation which the ultimate shareholders will bear, ie both corporation tax on the gain arising on the assets sold by the vendor company and capital gains tax on the eventual disposal or winding up of the vendor company itself.
(d) The VAT payable on payments for restrictive or non-competition covenants may be considerable, whereas in a company sale this element is generally included in the price of the shares and therefore free of VAT.
(e) VAT may be a real cost for non-resident purchasers of assets, unless they are going to trade in the UK and can either recover input tax or treat the transaction as the transfer of a going concern.

Impaired debt

[2.9] There are specific rules on impaired debts between connected parties that may result in unexpected tax charges. This area is complex and should be considered on any transaction where debts are acquired at less than face value.

Value added tax

[2.10] VAT may be payable on the purchase of assets whereas the purchase of shares is generally exempt. However, where the sale of shares is to a person who belongs outside the EU, it is outside the scope of VAT but with a full credit for input tax. Any contract for the sale of assets should deal expressly with the VAT treatment.

VAT – transfers as a going concern

[2.11] The charge to VAT can be avoided on the transfer of a business as a going concern ('TOGC') under Value Added Tax (Special Provisions) Order

1995 (SI 1995 No 1268) which provides that, where a business is sold as a going concern, no VAT is chargeable on the assets of the business provided that:

(a) the assets are to be used by the transferee in carrying on the same kind of business (whether or not as part of any existing business) as that carried on by the transferor in relation to the whole or part transferred; and
(b) where the transferor is a taxable person, the transferee is already, or immediately becomes as a result of the transfer, a taxable person; and
(c) there is no significant break in the normal pattern of trade either before or immediately after the transfer of the business.

If the sale comprises only part of a business the TOGC treatment will apply if, in addition to meeting the conditions set out above, that part is capable of separate operation.

If the sale includes the transfer of commercial property which has either been opted to tax or is the freehold sale of a commercial property less than three years old, TOGC treatment will only apply provided that the transferee also opts to tax and notifies HMRC on form VAT1614A no later than the completion date (or exchange date if a deposit is payable which creates a tax point). The transferee must also confirm to the vendor that the option to tax will not be disapplied under the anti-avoidance provisions in VATA 1994, Sch 10, para 12 (see HMRC Notice 742A, para 11.2).

If a transaction is not a TOGC, VAT will be chargeable on all taxable assets, eg goodwill, stock and plant and machinery and on certain commercial land and buildings. For detailed coverage, see the chapter *Land and Buildings* in Tolley's VAT Planning.

Whether or not a transaction will qualify as a TOGC is determined on the facts, and it will usually be agreed between the parties during the course of negotiations, although HMRC is not bound by the decision of the parties. While HMRC may give rulings on whether a transaction is or is not a TOGC, in routine cases it will decline to do so. Prudent vendors will therefore seek to secure their position with cash or other security to cover their VAT liability until confirmation of the position has been obtained. The contract for the sale will usually stipulate that the agreed consideration is exclusive of any VAT which may be payable.

VAT groups

[2.12] A company being purchased may be part of a VAT group under VATA 1994, s 43. The constitution of VAT groups and their consequences are discussed in **CHAPTER 53 SELLING A COMPANY**.

Hive-downs

[2.13] There is something of a middle path between the acquisition of an undertaking and its assets, and the acquisition of a company. A 'hive-down' is

the process whereby some or all of the assets and undertaking of a particular business (including its contracts and employees) are transferred from the vendor company (the 'predecessor') to a wholly-owned subsidiary (the 'successor') which is then acquired by the purchaser. What the purchaser eventually obtains is a company holding those assets and that part of the business which the vendor wishes to dispose of and the purchaser wishes to acquire.

The tax rationale of the hive-down

[2.14] A summary of the tax legislation affecting hive-downs is set out in the following paragraphs.

Group asset transfers

[2.15] By virtue of TCGA 1992, s 171 the transfer of assets between two companies which are within the same capital gains group takes place on a no gain/no loss basis and, accordingly, there is no charge to corporation tax on any capital gain to the date of that transfer. The purchaser must consider the operation of TCGA 1992, s 179, on capital gains and on intellectual property however, as it may impose a charge to tax if the hive-down company leaves the vendor's group within the period of six years from the date of transfer. This position was mitigated in FA 2011 for capital gains only and FA 2019 for the intangible assets regime, see **2.48** et seq.

Trading losses

[2.16] Any trading losses of the trade being passed down are available to the transferee company pursuant to the provisions of CTA 2010, Part 22, ss 938–949. However, the loss to carry forward is reduced by the extent to which the 'relevant liabilities' (broadly, liabilities outstanding in the predecessor before it ceased to carry on the trade and which are not transferred to the successor) exceed the 'relevant assets' at the time of the transfer. The anti-avoidance provisions provide for the restriction to apply even where there is a transfer of a trade within a group following a change in ownership. It also covers shell companies with non-trading loan relationship debits or non-trading intangible deficits.

The Finance Act 2015 contains further anti-avoidance legislation on losses taking effect from 18 March 2015. The new provisions were introduced to counteract the advantages purported to be gained by companies entering into contrived arrangements to circumvent the rules on carry forward of losses and group relief by endeavouring to refresh historical losses. This applies to losses which are carried forward under CTA 2010, s 45, non-trading deficits carried forward under CTA 2009, s 457 and management expenses carried forward under CTA 2009, s 1223. There are transitional provisions in place for accounting periods straddling 18 March 2015 whereby two notional accounting periods are created for this purpose.

The anti-avoidance provisions only apply if the conditions as set out in CTA 2010, s 730G are met, namely:

Condition A is that:

- the company has profits ('the relevant profits') for an accounting period;
- the relevant profits arise as a result of any arrangements ('the tax arrangements'), and
- in the absence of this section the company ('the relevant company') would be entitled to deduct historical losses from those profits.

Condition B is that:

- the company, or a connected company, brings a deductible amount into account; and
- it is reasonable to assume that neither the company, nor any connected company would have brought that amount into account as a deduction but for the tax arrangements.

Condition C is that the main purpose, or one of the main purposes, of the tax arrangements is to secure a relevant corporation tax advantage for the relevant company, or for the relevant company and any connected companies.

In its general letter to the Institute of Chartered Accountants on *Furniss v Dawson*, for the text of which see 1985 STI 568, the then Inland Revenue indicated that where a receiver intending to sell off a company, trade or part of one effects a hive-down, the *Ramsay* approach will not normally be considered relevant provided the entire trade (or part) and its assets are transferred with a view to its being carried on in other hands.

The Finance (No 2) Act 2017 has made significant changes to the rules for losses carried forward which are detailed at **2.47**.

'Arrangements' for sale and beneficial ownership

[2.17] The state of agreement reached between the vendor and the purchaser at the time that the hive-down takes place is critical to obtaining the continuation of these reliefs. If beneficial ownership of the vendor's trade or of the hive-down company has effectively passed to the purchaser before the legal transfer of the trade from the vendor to the hive-down company, relief will not be granted (*Wood Preservation Ltd v Prior* 45 TC 112). In that case, it was held that the vendor had ceased to be the beneficial owner of its shares in a subsidiary from the date of acceptance of a conditional offer, and the subsidiary was not entitled to relief in respect of the unused losses of the trade sold to it by the vendor.

The question of what constitutes 'beneficial ownership' was further considered by Millett J in *J Sainsbury plc v O'Connor* 64 TC 208, in which he held that the facts that (a) some of the shares of one shareholder in a joint venture company were the subject of an option for sale to the only other shareholder, and (b) the parties had bound themselves not to part with any of their shares without consent, did not prevent the shares under option from being beneficially owned by the original shareholder throughout the period of over four years during which the option existed. In particular, he distinguished the *Wood Preservation* case, in which the vendor had done all in its power to divest itself of its shares (subject to a condition over which it had no control). In the

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Sainsbury case there was merely an irrevocable offer to sell the shares in question. If that offer was not taken up (and he noted that the offer had not in fact been taken up) all the dividends on the shares in question belonged to Sainsbury, and so would any liquidation proceeds had the company been wound up. This decision was confirmed by the Court of Appeal (64 TC 237 et seq), although the effect of the decision in this case has been nullified by CTA 2010, Part 5, ss 169–182.

Transfer of the trade

[2.18] It is also important to ensure in the case of the sale of a hive-down company that the trade has been effectively transferred for tax purposes. The trade must be taken over as a continuing trade and it must have the same continuing identity. In *Laycock v Freeman Hardy and Willis Ltd* 22 TC 288, the Court of Appeal held that the transfer of shoe manufacturing operations from a subsidiary to its shoe retailing parent caused a change in the trade since neither company now operated as a wholesaler; in *Rolls-Royce Motors Ltd v Bamford* 51 TC 319, the consequence of transferring the businesses of the remaining two out of six divisions (all of whose activities had previously been treated as one trade for tax purposes) into the transferee company was considered. The scale of the trade carried on by the transferee was so reduced that the Court of Appeal held on the facts that the transferee was carrying on a different trade.

These decisions and their impact were reviewed by Millett J in *Falmer Jeans Ltd v Rodin* 63 TC 55 in relation to the provisions now contained in CTA 2010, ss 939 et seq. In this case, the taxpayer ('FJ') claimed the right to set off losses made by its subsidiary ('FM') in years prior to the acquisition of FM's business by FJ against its own profits made after the acquisition. FM had manufactured jeans for FJ, which had sold them. Millett J considered that there was no material difference of fact between *Falmer Jeans* and the *Freeman Hardy and Willis* case, but decided that he could distinguish the earlier case because the then legislation was different from that interpreted in this case.

This topic was visited again by Sir Donald Nicholls VC in *Maidment v Kibby* 66 TC 137, in which reference was made to *Freeman Hardy & Willis* but not to *Falmer Jeans*. This case concerned the sale in 1987 of a fish and chip shop business in Caldicot by Mr Franco to Mr and Mrs Kibby, who already ran a similar business in Chepstow five miles away. The Revenue contended that the Kibbys had started a new business in Caldicot and therefore should pay tax on its profits on the commencement basis. The taxpayers said that they had expanded their existing business and should pay income tax on all their profits on the preceding year basis. The judge, having reviewed the factual findings of the Commissioners that the owners 'had continued an existing and enlarged trade rather than succeeding to a new one', agreed with the taxpayers.

In a recent case, *Leekes Ltd v Revenue and Customs Comrs* [2015] UKFTT 93 (TC), [2015] SFTD 433, [2015] SWTI 1564, it was held by the Lower Tribunal that loss-streaming may not be necessary where a loss-making trade is transferred provided that the successor carries on the whole of the transfer trade as part of its existing trading activities. Unfortunately this was reversed

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by the Upper Tribunal (*Revenue and Customs Comrs v Leekes Limited* [2016] UKUT 320) so we are now back to HMRC's position that loss-streaming is usually necessary.

Intra-group debts

[2.19] Trade debts are brought into the loan relationship regime by CTA 2009, s 479 to the extent that they are impaired. Historically the problem was that the legislation was drafted to include only creditor companies. Hence CTA 2009, s 94 applied to tax the debtor while the creditor was unable to obtain a deduction. The only exceptions were where the debt was released as part of a voluntary arrangement or where the debt did not fall to be satisfied by the payment of money. CTA 2009, s 353 provides that, for debts formally written off on or after 22 April 2009, there is no tax impact on either the debtor or the creditor.

Where there is a disposal or acquisition of rights under a loan relationship between two members of the same capital gains group, if, as part of that transaction, one company replaces the other as a party to a loan relationship, the transfer of the loan relationship does not give rise to a taxable release (CTA 2009, s 336).

Capital allowances

[2.20] Where a trade is sold, CAA 2001, s 559 provides that the business is deemed to have been discontinued and accordingly balancing charges may arise. However, where CTA 2010, s 948 applies to a transfer of trade it is not treated as permanently discontinued for the purposes of capital allowances. Instead, the transferee steps into the shoes of the transferor for these purposes so that it obtains the same allowances and suffers the same charges as would have arisen to the transferor.

Where the change takes place part way through an accounting period the original guidance contained within CCAB Technical Release 500 (dated 10 March 1983) states:

> 'The transfer of the trade may take place during the currency of the accounting periods of the companies concerned. In those circumstances the Inland Revenue take the view that ICTA 1988, s 343 [now CTA 2010, s 948] should normally be applied as follows:
>
> (a) Writing-down allowances are calculated on the "pool" of qualifying expenditure held by the transferee at the end of its accounting period, and those allowances are apportioned on a time basis for the period in which each company carried on the trade.
>
> (b) First-year allowances are given to the company which actually incurred the expenditure, no apportionment being necessary. The reduction in the quantum of annual investment allowances for periods of less than 12 months should be taken into account.
>
> (c) Any balancing adjustments (whether charges or allowances) are made on the company carrying on the trade at the relevant time, without any apportionment. Following FA 2007, s 36, balancing adjustments are no longer made on industrial or agricultural buildings.

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> . . . where there is a transfer of part of a trade, any necessary apportionment of the "pool" of qualifying expenditure should be made on a just and reasonable basis'.

This does not entirely accord with HMRC's guidance at CA15400, which states:

> 'If the whole of a trade is transferred under a company reconstruction without change of ownership and Chapter 1 of Part 22 of CTA 2010 applies the transfer is ignored for capital allowance purposes. The successor company gets the same allowances and suffers the same charges as the predecessor would have got if it had continued to carry on the trade.
>
> Where the whole of a trade is transferred to a company which takes on as its own trade treat the predecessor as having a chargeable period which ends on the transfer date and the successor as having a chargeable period which begins on this date.
>
> Where only part of a trade is transferred, treat that part as a separate notional trade of the predecessor from the beginning of the accounting period in which the transfer takes place. Apportion capital allowance assets between that part and the balance of the trade on a just and reasonable basis. Allowances in respect of the part being transferred should be computed as though a notional chargeable period ended on the transfer date. Allowances in respect of the balance of the trade should be computed in the normal way.
>
> If the trade (or part) transferred from the predecessor to the successor expands a pre-existing trade, or if the successor has no pre-existing trade but acquires a trade (or part) from another person at the same time, the transferred trade (or part) should be treated as a separate notional trade of the successor. The successor should be treated as having a notional chargeable period that commences on the transfer date and runs to the end of the successor's accounting period.'

In practice the impact of this may be small but you will need to look carefully at the impact of the differing guidance and decide which to follow where necessary.

Where assets qualifying for capital allowances are transferred between companies which are connected persons (as defined in CTA 2010, s 1122) in circumstances in which Part 22, Chapter 1 does not apply, elections can be made by both companies under CAA 2001, ss 266 and 569 which allow the transfer of the assets at their written-down value for tax purposes in most cases.

Value added tax

[2.21] Careful attention in relation to VAT must now be given on an intra-group sale of assets. If both companies are members of the same VAT group, then no charge to tax will arise subject to the anti-avoidance provisions contained in VATA 1994, Sch 9A. These enable HMRC to direct that certain supplies made between members of a VAT group are to be subject to tax. However, arrangements undertaken mainly for genuine commercial reasons and not for the sole purpose of VAT avoidance should not be affected. If they are not members of the same VAT group, VAT will be payable unless it is an exempt supply or the transfer of a going concern, as explained at **2.11**. In many cases, a single asset which is not itself a business may be transferred from another member of the corporate group to the hive-down company to give it

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all the assets which are to be transferred to the purchaser in one neat parcel. The TOGC rules do not apply to the transfer of an isolated asset which does not form part of a business with which it is transferred. In these circumstances, it may be better for the vendor group and the purchaser to agree that such assets should be sold directly to the purchaser rather than to the hive-down company. For the purchaser, this also overcomes the problems which would otherwise arise under TCGA 1992, s 179, as mentioned at **2.15**, in relation to that asset.

Where a VAT group has a turnover of more than £10 million additional conditions must be met to allow grouping. The purposes of these provisions are to prevent certain suppliers from being in the same VAT group as their customers and to prevent an avoidance scheme which allowed partly exempt traders to buy services free of VAT.

Factors to be considered in the purchase of a company

Introduction

[2.22] It is assumed for the purposes of this chapter that the company to be acquired was incorporated, and has throughout been resident only in the United Kingdom. It is also assumed (unless otherwise stated) that all the parties involved in the transaction are themselves resident in the United Kingdom and do not constitute connected persons for the purposes of CTA 2010, s 1122 or TCGA 1992, s 286, and that accordingly it is appropriate to treat the whole transaction as being at arm's length.

Value added tax

[2.23] No VAT is payable on the acquisition of shares, but VAT may still be a major consideration, especially if the target is a member of the vendor's VAT group registration. Members of a VAT group are jointly and severally liable for the group's VAT liabilities, so that warranties and indemnities will be required in respect of the vendor group's VAT liabilities.

Furthermore, group treatment may result in VAT liabilities being calculated in a different way from the calculations appropriate to separately registered companies (*C & E Comrs. v Kingfisher plc* [1994] STC 63). Even if not registered as part of a group, the target may have acquired assets from other members of the vendor's group in relation to which there may be liabilities under the capital goods scheme.

Form of consideration on acquisition

[2.24] The consideration given by the purchaser for the acquisition of the target can take many forms.

In some cases, the purchaser will simply pay cash. In tax terms this is the simplest route, but commercially it may require the purchaser to be able to

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meet the interest cost of any borrowings taken to finance the purchase out of the profits derived from the company acquired. Loan relationship debits (eg interest, discounts and premiums payable) incurred for the purpose of acquiring a company (ie for non-trading purposes) are automatically deducted from non-trading credits (eg interest, discounts and premiums receivable) in computing the amount chargeable. If the debits exceed the credits, a 'non-trading deficit' arises for the accounting period.

Where there is a non-trading deficit on a company's loan relationships, the company may make a claim for the whole or any part of the deficit to be treated in any of the following ways:

(a) to be set off against any profits of the company (of whatever description) for the period;
(b) to be group relieved;
(c) for deficits arising before 1 April 2017 to be carried back to be set off against profits arising from the company's loan relationships of the previous twelve months, including non-trading foreign exchange and financial instruments profits;
(d) for deficits arising on or after 1 April 2017 to be carried back to be set off against total profits of the previous 12 months;
(e) for non-trading deficits arising before 1 April 2017 to be carried forward and set against non-trading profits for the next accounting period; or
(f) for non-trading deficits arising on or after 1 April 2017 to be carried forward and set against total profits in future accounting period. However, where an investment business becomes small or negligible in the period that the deficit arose or a later period it can only be offset against future non-trading profits.

(CTA 2009, Part 5, Chapter 16, ss 456–463.)

From 1 April 2017, losses brought forward can only be offset against 50% of total taxable profits subject to a £5 million allowance, see **2.47**.

The amount available for group relief under (b) is the amount which would be allowed as group relief under CTA 2010, s 99, and is the deficit for the period even if the company has other profits in the same accounting period against which the deficit could be offset. Where the purchasing company borrows funds prior to acquisition of the target, under the loan relationship rules interest accruing in an accounting period prior to acquisition may not be group-relieved against the profits of the target, though the rules are slightly more generous from 1 April 2017 (see below). However, if there are other profitable companies in the acquiring group, it may surrender the loan relationship deficit as group relief.

For deficits arising on or after 1 April 2017 it is possible to surrender deficits brought forward from previous years, see **2.57**.

An alternative may be to hive up the trading activities immediately on acquisition. On this basis the question of group relief is not in point and there is a greater likelihood of being able to offset excess interest in future periods. It should, however, be remembered that the cessation of a trade in a company brings the accounting period to an end, which may advance the payment date of any corporation tax.

Exchange of securities

[2.25] The attraction of a paper for paper transaction for the purchaser is that it requires neither external borrowing nor the use of existing cash resources of its business to finance the purchase. The form of the purchaser's paper given to the vendor can vary widely and include ordinary or preference shares of the purchaser, and fixed term secured or unsecured debentures and loan notes. Loan notes and debentures may carry rights of conversion into shares, depending upon the future results of the target company. On their part, vendors may like to take paper rather than cash in order to postpone (also interest-free) any present liability to capital gains tax or to keep an investment in the shares of a company whose value may be expected to continue growing.

However, the favourable treatment for capital gains tax entrepreneurs' relief and the consequent cost of losing this relief is likely to lead to more detailed investigation by the vendor of the purchasing vehicle itself and the nature of the securities offered.

For further details and discussion see **CHAPTER 53 SELLING A COMPANY**.

The postponement of the vendor's liability to capital gains tax is achieved under TCGA 1992, s 135, which provides that new securities acquired are to be treated as a continuous holding of the securities exchanged. Subject to TCGA 1992, s 137, this happens automatically where a company (company A) issues shares or debentures to a person in exchange for shares or debentures in another company (company B), and:

(a) company A holds, or in consequence of the exchange will hold, more than one quarter of the ordinary share capital (as defined in CTA 2010, s 1119), of company B, or
(b) company A issues shares or debentures in exchange for shares as the result of a general offer:
    (i) which is made to members of company B or any class of them (with or without exceptions for persons connected with company A); and
    (ii) which is made in the first instance on a condition such that if it were satisfied company A would have control of company B, or
(c) company A holds, or in consequence of the exchange will hold, the greater part of the voting power in company B.

In any case where the person to whom the shares or debentures are issued holds more than 5% of, or of any class of, shares or debentures of the target, the relief will only apply where the exchange is effected for *bona fide* commercial reasons and does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is the avoidance of liability to capital gains tax or corporation tax (TCGA 1992, s 137). There are detailed definitions of all the terms used to prevent the abuse of the relief and there is a prior clearance procedure under TCGA 1992, s 138.

HMRC has 30 days from receipt of the clearance application to notify the applicant of its decision or to request further particulars. The clearance procedure is merely to establish that HMRC is satisfied that the exchange is effected for *bona fide* commercial reasons and is not part of a scheme or

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arrangement to avoid a liability to capital gains tax or corporation tax. The obtaining of a clearance is not, therefore, confirmation that the other conditions for obtaining relief are satisfied.

Deferred consideration

[2.26] In many private company acquisitions the purchaser feels that there is considerable uncertainty about how well the target will perform after it has been acquired. It often therefore tries to secure best value, and to tie in the vendors or vendor managers and directors, by making part of the consideration dependent on the profits of the target or the growth in value of the business over a number of years.

Where the contingent consideration takes the form of an additional cash payment, the principles of *Marren v Ingles* 54 TC 76 apply, so that the market value of the deferred consideration at the date of the contract (discounted both with respect to the time and uncertainty of receipt) is ascertained and taxed on that occasion. The taxable amount then represents the base cost for capital gains purposes of the right to receive the additional consideration. Where, very broadly, the earn-out right can only be satisfied with securities in the new company, TCGA 1992, s 138A allows the right itself to be treated as a security, and thus the CGT liability to be deferred. This treatment applies automatically unless an election is made to the contrary. The existence of contingent consideration may also give rise to an increased stamp duty charge at the time of purchase, so that the documents need to be drafted carefully in this respect.

In so far as the contingent consideration takes the form of shares or other securities, TCGA 1992, s 138A deals with fixing and postponing the liability to capital gains tax on the contingent element of the consideration. For a fuller discussion on the above issues, see **CHAPTER 53 SELLING A COMPANY**.

Payments to directors and employees

[2.27] Often the purchaser will terminate the service contracts of some directors or senior executives of the target on or soon after making the acquisition. HMRC may seek to treat any 'golden handshake' paid to a vendor as part of the sale consideration, rather than as an income payment with a £30,000 exemption. In these circumstances HMRC may argue that payments made by the target as compensation for loss of office to its directors are not deductible in computing its profits. The leading case is *James Snook & Co Ltd v Blasdale* 33 TC 244. The onus is on the target company to show that it considered the question of payment wholly untrammelled by the terms of the bargain which its shareholders had struck, and came to a decision to pay retiring directors solely in the interests of its trade.

HMRC may now attack lump sum payments to employees and directors as retirement payments pursuant to HMRC Statement of Practice SP 13/91, though strictly the statement does not apply from 6 April 2006.

Care needs to be taken where special arrangements are in place on allocation of proceeds, as these may create a PAYE liability on the company (*Grays Timber Products v Revenue & Customs Comrs*. [2010] UKSC 4, [2010] 2 All ER 1, [2010] STC 782).

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Other forms of consideration

[2.28] A number of other forms of consideration are commercially possible. It is important to bear in mind, however, that the transfer of any assets to the vendors other than cash or securities of the purchaser may trigger a liability to corporation tax on capital gains for the purchaser and may give the vendor a liability to pay stamp duty or SDLT.

Shares and options

[2.29] Where the target company has granted options over shares to its employees, those options may lapse, or may be exercisable within a limited period and will then lapse, or, in the case of approved share schemes, may be rolled over into new options over shares in the acquiring company providing the scheme rules permit this and the acquiring company agrees. If the rules of the target's scheme are appropriately worded, the exchange of options can take place without express prior HMRC approval. It is essential, however, that the terms of the new options mirror those of the old options in all material respects and that the prescribed formula for matching values is followed. If unapproved options are substituted for approved options after a takeover, the approval of the scheme will be lost.

Where the holder of an approved share option (not an EMI option) exercises the option less than three years after the date the option was granted, an income tax charge will arise on exercise. If employees are able to sell the shares they acquire on the exercise of the option for cash, they will have funds to meet the income tax liability. There may be problems if the offer is not in the form of cash but instead is for shares in the acquiring company.

As an alternative, the acquiring company may offer cash to option holders for releasing or cancelling their options. Any sum received in exchange for the release of an option will be taxable by virtue of ITEPA 2003, Chapter 5, s 471 et seq on the difference between the amount received for the release and any amount paid for the grant of the option. In a limited number of cases, the rules of the scheme may be so written as to permit the options to subsist notwithstanding the takeover. Where this occurs, the purchaser may need to offer to buy their cancellation from the option holders.

The position is somewhat different for options granted under an Enterprise Management Incentive (EMI) scheme. The takeover of a company is a disqualifying event under ITEPA 2003, s 532. However, provided the EMI option is exercised within 40 days of the event the tax benefits remain.

ITEPA 2003, Part 7 contains anti-avoidance legislation on certain share incentives, namely restricted securities, convertible securities and securities with an artificially enhanced or depressed value. There are tax and NIC risks associated with such shares that would need to be considered in a takeover.

For a fuller discussion of the position of share and option holders in a takeover, see **Chapter 16 Employee Share Option and Share Incentive Schemes**.

Pensions

[2.30] Another factor which will affect the purchase price is the surplus or deficit on the target's pension fund. Specialist advice should be sought on the

negotiation of the transfer of pension fund assets and liabilities and on the drafting of the sale agreement in this respect.

Existence of employee remuneration or pension structures

[2.31] ITEPA 2003, Part 7A contains the legislation for remuneration to past, present or future employees, provided through third parties. Such third parties include, but are not restricted to, Employee Benefit Trusts and offshore pension schemes. The law, which is lengthy and complex, provides for PAYE to fall due on the company, rather than the trustees, in defined circumstances, including making or waiving loans, provision of assets and earmarking of funds. If PAYE is not reimbursed by the employee the sum has to be grossed up leaving the company with a cost that may be in excess of the value received by the individual. The existence of such structures and the inherent risk of liability can impact significantly on any purchase.

Any outstanding loans that were made after 5 April 1999, that were still in place at 5 April 2019 will now be subject to PAYE and NIC at that date, unless they have already been taxed in full.

It is therefore important for the buyer to find out as much as possible about the arrangements and the current status of any HMRC enquiry. Hopefully this gives an indication of any historic liabilities and also what needs to be done to manage the arrangements going forward to avoid future tax charges.

One key issue to consider is that the trustees of a trust must act in the best interest of the beneficiaries and not of the company itself or the buyer. The extent to which the buyer will be able to control the occurrence of taxable events in relation to the trust may therefore be limited.

It is normal to require a specific tax indemnity in the sale and purchase documentation such that the sellers provide specific indemnities for any remuneration planning undertaken.

It is likely to take some time after the acquisition for any final resolution with HMRC. The amount of tax at stake will usually be relatively easy to calculate. The buyer would therefore normally seek a retention from the consideration payable to cover the future liability.

Follower and accelerated payment legislation

[2.32] The Finance Act 2014, Part 4 and the Finance (No 2) Act 2017, Sch 17 include provisions to aid HMRC in collecting additional tax in regard to:

- existing enquiries into planning arrangements, where a court has ruled on a similar point in HMRC's favour; and
- any tax withheld by reason of planning arrangements which fall under the Disclosure of Tax Avoidance Schemes (DOTAS) provisions or are challenged under the GAAR.

It will be important for the buyer fully to understand the nature of any planning undertaken and of HMRC's challenge. Again, a specific indemnity will be required in the sale and purchase agreement to cover any such arrangements and potentially a retention to cover future liabilities. It will,

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though, also be necessary to agree the position as to any continuing defence of the plans including the costs and any increased penalties.

The purchase transaction

The purchase and sale agreement – warranties and indemnities

[2.33] The essence of the transaction as far as the purchaser is concerned is that he should get what appears to be on offer and that he is not paying too much for it. Accordingly, the contract for the purchase will normally set out in detail a series of statements ('the warranties') which the purchaser will require the vendor (and in some cases its directors) to warrant are true. The contract will further provide that the warrantors will compensate the purchaser against the consequences of any breach of the warranties together with interest and reimbursement of any associated costs incurred in pursuing the claim. The warranties will apply except insofar as relevant circumstances are notified to the purchaser. The vendor, in order to limit its liabilities, will usually provide a disclosure letter which will divulge actual or potential divergences from the statements warranted and which is intended to disclaim responsibility or liability for any matter or issue disclosed. During the process of discussion of the warranties there may be an adjustment to the price to reflect matters which emerge out of the disclosure letter.

There will also normally be a deed of indemnity signed by the vendor indemnifying the purchaser and the target against losses suffered as a result of events specified in the deed. The sale contract itself usually contains provisions setting the maximum and minimum amounts which the purchaser (or the target) can claim from the vendor under the warranties and indemnities and the time limits within which claims must be made following completion of the purchase.

The contract and deed of indemnity therefore may establish two, and in some cases three, overlapping remedies for the purchaser.

(a) It may be given the right to rescind the agreement, eg if it discovers material discrepancies from the warranties or disclosures before (or, sometimes, even after) completion.
(b) An action for breach of warranty, ie a claim for breach of contract.
(c) A right to be indemnified under the deed of indemnity.

Both remedies (b) and (c) would give rise to a cash payment, but the measure of damage for a breach of contract is the net loss to the purchaser, whereas the measure of loss under an indemnity is the amount which has to be replaced.

A further major consideration is the identity of the person or company to whom the benefit of the obligation is given. If an indemnity is given to the target, the compensation will normally be the amount it has lost before taxation. This may well be a larger sum than would be payable for breach of a warranty to the purchaser, who only has to be compensated for the net diminution in the capital value of its asset (ie the shares in the target company) after all taxes have been taken into account.

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If a purchaser does receive a payment for breach of a warranty, it has to consider whether it will suffer tax on the compensation payment. In *Zim Properties Ltd v Proctor* 58 TC 371, the High Court held that the right to compensation or damages could itself be an asset for capital gains tax purposes, and that the resulting payment of compensation could constitute a capital payment derived from such an asset. Accordingly, a chargeable gain would arise on the full capital sum received, as the asset would normally have no base cost.

The danger of a tax charge falling on the purchaser as a result of a payment under a warranty or an indemnity has been limited by Extra-Statutory Concession D33, which includes the following paragraph.

> 'The principle in *Zim Properties Ltd* is not regarded as applicable to payments made by the vendor to the purchaser of an asset under a warranty or indemnity included as one of the terms of a contract of purchase and sale.
>
> Where such a contractual payment is made, then the cost of the asset to the person acquiring it will, on the occasion of a further disposal be reduced by the sum received. The sale proceeds of the person who makes (or is treated by TCGA 1992 s 171A as making) the disposal of the asset are adjusted under TCGA 1992 s 49 in respect of the sum received. Where a warranty or indemnity payment is not made in accordance with the terms of the contract, the principle in *Zim Properties* may apply and the sums received by the vendor or purchaser as appropriate may be identified as capital sums derived from the asset, or from the right of action, depending on the facts of the case.'

Nevertheless, purchasers may ask for indemnities which protect them from the tax consequences by 'grossing-up' any payment to be made. Care should be taken to ensure that the effects of this tie in logically with other clauses, especially in an earnout, where the final price may be determined by reference to a multiple of profits to be earned in the period after completion. Otherwise, the purchaser may find that clauses designed to protect its position may operate against its interests overall.

There can be problems with managing large tax risks, eg where tax planning schemes have been undertaken. In these circumstances it may be worth looking at the possibility of insuring the risk.

One key problem on warranties on sales is that under TCGA 1992, s 49 the seller is taxed on the full consideration ignoring any potential warranty claims. If a payment is due a claim may be made to amend the original capital gains computation. However, such claims must be made within four years of the end of the tax year in which the disposal was made. The seller and purchaser will, therefore, have to agree the position on the limits for claims with each party having different requirements.

The tax warranties

[2.34] As mentioned above, the warranties are designed to ensure that the purchaser obtains what appears to be being offered and has an effective remedy if what he gets is not what he was promised. This is particularly important in relation to tax, because the tax position of the company is often its least visible aspect to the outsider. Furthermore, there may be uncertainties and matters in dispute which affect the value of that company.

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The rules on penalties introduced with effect for accounting periods beginning on or after 1 April 2008 introduced new concepts on penalties and disclosure. The penalties for prompted disclosure are considerably higher, a minimum of 15% higher, than for voluntary disclosure. The vendor may therefore wish, in some way, to bind the purchaser to make a voluntary disclosure with a view to reducing penalties even though this would advance payment of tax.

It is not possible to give a complete list of the tax warranties which could be contained in the purchase contract, and each contract should contain specific tax and other warranties relating to the nature of the business in which the target operates, but the following paragraphs provide a summary of warranties which are often found in share purchase contracts. Unless otherwise stated 'tax' includes all impositions described as 'tax' plus national insurance contributions, customs duties, excise duties and all other taxes and duties. Interest and penalties relating to such taxes are normally covered as well.

General tax warranties

[2.35] General tax warranties often include the following:

(a) The target was incorporated in the United Kingdom; is and always has been resident only in the United Kingdom; has never been dual resident or resident in any other territory whether under principal legislation or any double taxation agreement; has never traded or invested outside the United Kingdom through a permanent establishment, branch or agency; and has never changed or attempted to change its residence from the United Kingdom.

(b) All tax returns due, including any disclosure under the Disclosure of Tax Avoidance Schemes provisions, have been correctly made on a timely basis and no tax returns are disputed by the tax authorities.

(c) All tax due has been paid, including tax and national insurance contributions due under PAYE and corporation tax payable by instalments.

(d) All assessments not so paid have been properly appealed against and (where appropriate) payment of any tax assessed and not paid has been postponed.

(e) All tax due in the current year will be properly calculated and provided for in the completion accounts.

(f) Provisions for tax in the last set of statutory accounts are adequate.

(g) The target is not and never has been a close company or a close investment-holding company.

(h) No transactions have been entered into triggering any of the principal anti-avoidance sections of the Taxes Acts.

(i) The target has not entered into any scheme or transactions which fall under the Disclosure of Tax Avoidance Schemes (DOTAS) provisions or could be challenged under the GAAR.

(j) All tax clearances obtained (if any) have been disclosed.

(k) All tax warranties and indemnities given to or received from third parties (if any) have been disclosed.

(l) All available claims for double tax credit relief have been duly made.

(m) No investment grants are liable to be repaid.

(n) There are no outstanding or ongoing enquiries from HMRC or other fiscal authorities whether in the United Kingdom or elsewhere.
(o) No interest is held by the target in a controlled foreign company as defined in Part 9A of TIOPA 2010.
(p) No transactions or arrangements have been entered into that could give rise to a Diverted Profits Tax liability.

Corporation tax

[2.36] Corporation tax warranties often include the following:

(Relating to chargeable gains)

(a) No claims for roll-over relief under TCGA 1992, ss 23, 152–158 or 247 have been made by the target.
(b) No claims for the postponement of corporation tax on chargeable gains on the transfer of a trade under TCGA 1992, s 140 or the transfer of an EC trade under TCGA 1992, s 140C, have been made by the target.
(c) The base values of the target's assets in its books and accounts are the same as for tax purposes.
(d) There are no capital losses carried forward by the target which are or might be affected by TCGA 1992, s 177A and Sch 7A (restriction of set-off of pre-entry losses).
(e) There are no liabilities under TCGA 1992, s 179 which may arise on the target leaving its existing group (or there are provisions for an election to be made under s 171A).
(f) There have been no depreciatory transactions within TCGA 1992, s 176 and no value-shifting transactions within TCGA 1992, ss 17 or 29–34 that affect the target.
(g) No election has been made for all the target's assets then held to have a 31 March 1982 base value under TCGA 1992, s 35(5).
(h) The capital gains base values of the target's assets are not liable to be reduced under TCGA 1992, Sch 3, para 4(2) (part disposals).
(i) The target has not acquired any assets subject to a claim for hold-over relief under TCGA 1992, s 165 (relief for gifts of business assets).
(j) The target has no capital gains or losses which are (or might be) affected by TCGA 1992, ss 184A–184I (restrictions on buying losses or gains).

(Relating to income and corporation tax)

(a) There are no trading or other losses carried forward or, if there are, there is no likely restriction on loss relief as a result of a major change or decline in the scale of the target's activities within the relevant periods.
(b) Where there are tax losses brought forward the disclosure letter provides an adequate analysis between those arising before 1 April 2017 and those arising on or after 1 April 2017.
(c) Where losses are brought forward the company holds no assets on which if disposed of there would be a restriction of loss set-off under CTA 2009, s 676BC (as introduced in the Finance (No 2) Act 2017) against the gain (or deemed gain under an election under TCGA 1992, s 171A).

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(d) The target has properly accounted for and paid over all sums due by way of income tax which is due to be deducted at source, for example in respect of annual interest and certain payments to non-residents or to sub-contractors in the construction industry.
(e) No payments are liable to be disallowed, reliefs restricted, etc by reason of the following provisions: CTA 2009, ss 53, 54, 59, 68, 103 and 231 (general rules as to deductions not allowable); CTA 2009, s 1301 (annual payments for non-taxable consideration); CTA 2010, Part 22, Chapter 1 (restrictions on carry-forward of trading losses on an intra-group transfer of trade); CTA 2010, Part 14, Chapter 6 (liability for corporation tax of former subsidiaries); CTA 2010, Part 14, Chapters 1–5 (carry-forward and back of trading losses); TIOPA 2010, Part 4 (sales, etc at undervalue or overvalue); CTA 2010, Part 19 (leased assets); CTA 2009, s 443 (restriction of relief for payments of interest) or TIOPA 2010 Part 10 (corporate interest restriction – as introduced in Schedule 5 to the Finance (No 2) Act 2017).
(f) The target holds no assets qualifying for capital allowances which are subject to the VAT capital goods scheme.
(g) The target has not been a party to a loan relationship which has an unallowable purpose within the meaning of CTA 2009, Part 5, Chapter 15, ss 441–443.
(h) There are no liabilities on loan relationships under CTA 2009, ss 344–347 which may arise on the target leaving its existing group.
(i) No claims for roll-over relief on intangible assets under CTA 2009, s 757 or 778 have been made with respect of the target.
(j) There are no liabilities under CTA 2009, s 780 or 785 which may arise on the target leaving its existing group (or there are provisions for an election to be made under s 792).
(k) There are no liabilities on derivatives under CTA 2009, ss 630–632 which may arise on the target leaving its existing group.

(Relating to stamp duty land tax)

(a) There are no liabilities which may arise on the target leaving its existing group.

(Group aspects)

(a) Group income elections have been made, where appropriate, between the target and other members of its current and former groups (if any). They have been in force in respect of all dividends and interest payments and accepted by HMRC.
(b) All claims for group relief and consortium relief by or concerning the target have been validly made and accepted by HMRC.
(c) All claims for surrender of ACT by or to the target have been validly made by the companies concerned and accepted by HMRC.

(Secondary tax liabilities)

This is an area of concern in that in acquiring a company out of a group it is possible that the purchaser is, in effect, taking over tax liabilities of the other companies. HMRC's powers in this area are extending, eg on capital gains (TCGA 1992, s 190) and on SDLT and intangibles clawbacks and it does have the power to enforce outstanding tax debts against other parties.

HMRC's guidance indicates that the provisions will normally be applied in cases of tax avoidance. However, the increased scope of HMRC's challenge on perceived tax avoidance means that the application of the secondary liability rules is very relevant.

The legislation is detailed and complex and should be considered in detail but some key issues are:

(a) For companies within the target's UK chargeable gains or intangible fixed asset groups;
  (i) TCGA 1992, s 190 provides that unpaid tax relating to a chargeable gain be recovered from the parent company at the time the gain arose and also from any other company that was part of the group at any point in the 12 months prior to the disposal where that company had owned the whole or any part of the asset disposed of;
  (ii) similar provisions exist on intangible fixed assets (CTA 2009, s 795);

(b) Changes in the ownership of vendor group companies (including the target company) can also give issues in that CTA 2010, s 713 provides that unpaid tax relating to a period ending on or after a change in ownership of a company may be recoverable from another person, if it would be reasonable to infer that a transaction connected to the change was entered into on the assumption that any potential tax liability would be unlikely to be met. The tax recoverable is not limited to that of the company which changed ownership but includes the unpaid tax of associated companies; broadly, companies that control, are controlled by, or are under common control. The unpaid tax may be recovered from any company that was so associated in the three years before the change in ownership. For these purposes control is defined as the company holding 50% of the share capital; voting power; or rights to distributions or to assets on a winding up. The economic test of control may mean that, in some cases, lenders could also find themselves in a controlling position.

(c) HMRC also has power to collect unpaid tax assessed in periods beginning before a change in ownership (CTA 2010, s 710) where the change in ownership is associated with, broadly, a significant contraction or a major change in the nature or conduct of the relevant company's trade or business. Again, tax is recoverable from any 'linked' person.

The timing of such charges may well be outside the normal six/seven year period and care must be taken and detailed reviews carried out in this area.

Securities and employee benefit schemes

[2.37] Warranties relating to securities and employee benefit schemes often include the following:

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(a) The target has not made and is not entitled to make a claim for relief under TCGA 1992, s 253 (loans to traders), TCGA 1992, s 254 (qualifying corporate bonds), CTA 2010, s 938 et seq (company reconstructions without a change of ownership), CTA 2010, s 45 and s 37 (losses) or under CTA 2010, s 68 (losses on unquoted shares in trading companies).
(b) The target neither owns nor has issued any of the following kinds of securities:
    (i) deep discount securities;
    (ii) deep gain securities;
    (iii) qualifying indexed securities; or
    (iv) restricted securities, convertible securities and securities with an artificially enhanced or depressed value.
(c) Neither the target nor any of its employees is affected by any of the following kinds of employee benefit scheme (whether approved by HMRC or not):
    (i) profit-sharing scheme;
    (ii) savings-related share option scheme;
    (iii) selective share option scheme;
    (iv) enterprise management incentive scheme;
    (v) employee share ownership plan (or 'share incentive plan');
    (vi) qualifying employee share ownership trust; or
    (vii) profit related pay scheme.
(d) The target is not a member of a European Economic Interest Grouping or any other kind of partnership, consortium or joint venture.
(e) No relevant step has been taken by a third party in respect of an employee of the target or a beneficiary of an employee benefit trust which has given rise to or could give rise to a liability under Part 7A of ITEPA 2003.

Stamp duty, stamp duty land tax and stamp duty reserve tax

[2.38] Warranties relating to stamp duty, stamp duty land tax or stamp duty reserve tax often include the following:

(a) All contracts and other documents entered into by the target have been duly stamped, or adjudicated not liable, and the target has no outstanding actual or contingent liabilities to stamp duty, SDLT or stamp duty reserve tax.
(b) The transaction itself will not give rise to any liability to such tax.
(c) Returns for SDLT have been validly made on a timely basis and any tax due has been paid.

Value added tax

[2.39] Warranties relating to VAT often include the following:

(a) The target is duly registered as a trader for the purposes of value added tax and is not partly or wholly exempt.
(b) The target's registration is independent of any other trader's registration and has its own number.

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(c) No interest surcharges or other penalties are actually or contingently due in respect of late returns or underpayments or otherwise.
(d) All reverse VAT charges under VATA 1994, s 8 have been properly accounted for.
(e) The target has complied with all the requirements of the VAT import and export schemes to which it is subject in the UK and elsewhere in the EC.
(f) The target is not and has never been certified as exempt from VAT under VATA 1994, s 54 (special flat rate scheme for farmers and certain others engaged in agriculture, forestry or fisheries) or operated a flat rate scheme under SI 1995 No 2518, regs 55A–55V (flat rate scheme for small businesses) and the target is not a party to any special schemes for the purposes of VAT.
(g) The target has not paid VAT on any land or buildings purchased or leased and has not elected to waive exemption from VAT in respect of any land or buildings currently owned or let or sold or agreed to be let or sold by it (whether in this contract or otherwise).
(h) The target has kept full records of all past bad debts and duly claimed back all VAT available for reclaim under VATA 1994, s 36, and has repaid input tax claimed when a supplier has not been paid within six months under SI 1995 No 2518, reg 172H.
(i) The target provides no domestic accommodation or ancillary goods or services for any directors or employees.
(j) The target has not purchased any assets in a transfer as a going concern.
(k) The target has not been supplied in the last ten years with any land, buildings, computers, equipment or any other goods or services affected by Part XV of the Value Added Tax Regulations 1995 (SI 1995 No 2518).
(l) The vendor has given the purchaser full details of assets to which the capital goods scheme applies, the use to which each has been put and the history of each for VAT adjustment purposes.
(m) The target has no liability for any other person's VAT or responsibility for any other person's VAT records as a current or former member of a VAT group or the acquirer of assets or of a business as a going concern.
(n) The target has not been a party to any transaction in respect of which a direction has been or is liable to be made under VATA 1994, Sch 9A.
(o) The target has not been a party to any arrangements which may require disclosure under VATA 1994, Sch 11A of the use of a VAT avoidance scheme, either a listed scheme or hallmarked scheme.

Inheritance tax and capital transfer tax

[2.40] A typical warranty is that the target has no actual or contingent liabilities, nor will the sale trigger any actual or contingent liability to these taxes.

National insurance contributions ('NICs') and PAYE

[2.41] Warranties relating to NICs and PAYE often include the following:

(a) Income tax has been correctly deducted from the remuneration of all employees under PAYE and has been accounted for to HMRC accurately and on a timely basis.
(b) The target has properly accounted for and paid all employer's and employees' NICs (including contributions on benefits assessed annually).
(c) All returns in respect of benefits for employees have been properly made.
(d) None of the target's employees are in contracted-out employments.
(e) No penalty notice has been issued.

Close company considerations

[2.42] Warranties relating to such considerations may be as follows:

(a) The target is not and never has been a close company; or, if it has,
(b) during any period during which the target has been a close company:
 (i) it has made no covenanted payments or payments to charity falling within CTA 2010, s 189 (formerly ICTA 1988, s 339);
 (ii) it has neither made nor released any loans to participators;
 (iii) it has acquired no qualifying insurance policies;
 (iv) it has incurred no expenses for the benefit of participators caught by CTA 2010, ss 1064–1069 (formerly ICTA 1988, s 418);
 (v) it has not redeemed or repaid any share or loan capital issued otherwise than for adequate consideration;
 (vi) it is not and has not been treated as a 'close investment-holding company' as defined in CTA 2010, s 34 (formerly ICTA 1988, s 13A);
 (vii) it has made no payments for the benefit of its participators such that an inheritance tax charge may arise on the participators (IHTA 1984, s 94(1)).

General anti-avoidance warranties

[2.43] It is also usual to require disclosure of any actual or potential liability to tax under any sections of the anti-avoidance legislation and, in particular, the following provisions:

(a) FA 2009, Sch 25 and CTA 2009, ss 486F–486G (tax avoidance: transfers of securities and transfer of assets abroad);
(b) CTA 2010, Part 19 (land sold and leased back: limitation of tax reliefs and assets leased to traders and others);
(c) CTA 2010, s 777 (transactions associated with loans or credit);
(d) ICTA 1988, ss 747–756 (controlled foreign companies);
(e) CAA 2001, ss 213–218 (capital allowances: effect of sales between connected persons, sale and leaseback, etc);
(f) CAA 2001, Sch 3, para 47 (exclusion of first-year allowances for certain leased assets) or CAA 2001, ss 109, 110 (allowances for assets leased outside the United Kingdom); and
(g) CTA 2010, s 782 et seq (manufactured dividends and interest).

Uniform business rates

[2.44] Warranties relating to uniform business rates may be as follows:

(a) The target has paid all sums due on its properties.
(b) There are no disputed matters as to the rateable value or rateable use of the target's land and buildings for the purposes of rating.

Tax provisions affected by an acquisition

[2.45] Some of the main tax considerations for the purchaser on making an acquisition concern the extent to which the acquisition itself and the conduct of the target's business immediately after the acquisition could affect the tax position (and thus the value) of the target.

Advance clearances

[2.46] By the nature of things, HMRC cannot know what the purchaser intends to do or what the precise effect of the purchaser's actions on the target's business will be. For this reason, there are at present few statutory clearance procedures available to a purchaser.

Such clearance procedures as there are apply principally to vendors and concern the following issues.

(a) Clearance from HMRC's BAI Clearance Team under CTA 2010, s 748 (for companies) and ITA 2007, s 701 (for individuals) that the anti-avoidance provisions of CTA 2010, s 733 et seq (for companies) and ITA 2007, s 682 et seq (for individuals) (counteracting tax advantages obtained or obtainable by persons in respect of transactions in securities) will not apply to the sale consideration.
(b) Clearance from HMRC's BAI Clearance Team under TCGA 1992, s 138 that the relief afforded by TCGA 1992, s 135 (exemption on exchange of securities) will not be prevented from applying to the shares or debentures to be issued to the vendor(s).

As to clearances under CTA 2010, s 748 or ITA 2007, s 701 and TCGA 1992, s 138, the details are dealt with in **CHAPTER 53 SELLING A COMPANY** at **53.46**, **53.49**. Although clearances under these two sections are primarily of benefit to the vendor, their relevance to the purchaser should not be underestimated. In practice, the availability of these clearances may influence the final form of the transaction. The vendor is unlikely to accept shares, debentures or loan notes from the purchaser company if he is to be denied relief under TCGA 1992, s 135, unless he is able to realise cash, for example by an immediate placing of the securities.

Similarly, if the form of the transaction is such that the vendor will have a liability to income tax or corporation tax on revenue on all or part of the proceeds by virtue of CTA 2010, ss 733–742 or ITA 2007, ss 686–690, he is very likely to require the transaction to be dealt with differently. In particular, the vendor may require the target to distribute a dividend prior to the sale. The

20% capital gains tax rate and the mitigation afforded by entrepreneurs' relief and investor's relief, for capital gains realised by individuals and trusts, increase the importance of obtaining clearance, since the differential between the rates of income tax and capital gains tax on a transaction can be substantial.

The prescribed circumstances in which a purchaser may directly be affected by the provisions are set out in CTA 2010, ss 736–738 or ITA 2007, ss 686–690. These provisions were originally enacted to prevent the abuse which was perceived in *Griffiths v J P Harrison (Watford) Ltd* 40 TC 281. In that case, a normal trading company incurred a loss in its trade. It added a share-dealing object to its memorandum and bought a company which had ceased trading, but which had distributable profits. The target then declared a large dividend and was then sold at a reduced value to a third party. There were no other relevant share dealings. The trading company successfully claimed that it had been trading in shares and securities and that the loss incurred both in its normal trading activity and in the share-dealing activity could be set off against the dividend it had received, resulting in a repayment of tax paid by the target company. The tax advantages derived from this series of transactions would now be counteracted under CTA 2010, s 733 et seq or ITA 2007, s 682 et seq.

Accordingly, a purchaser must look critically at the attractions of abnormal distributions from companies acquired with large distributable reserves, especially in the light of the guidance given in the then Inland Revenue Tax Bulletin November 1992, pages 37 to 39 (which is considered in relation to CTA 2010, Part 15 or ITA 2007, s 701 in **CHAPTER 53 SELLING A COMPANY**). A purchaser can apply for a clearance under these sections, but it is unusual for it to do so.

Trading (and similar) losses

[2.47] From 1 April 2017, there is a significant change in the way that corporate tax losses can be utilised. The new rules affect accounting periods commencing on or after 1 April 2017. Where an accounting period straddles 1 April 2017 the period is treated as two separate accounting periods and profits and losses are apportioned between the two periods. This is done on a time basis unless that would produce a result that is unjust or unreasonable in which case a just and reasonable basis is used.

Pre-1 April 2017 losses

Trading losses arising before 1 April 2017 may be set off in the following ways under CTA 2010, Part 4, Chapter 2:

(a) against any profits of the same company for the same accounting period;
(b) against the trading profits of the same trade in subsequent accounting periods, without time limit;
(c) against any profits of the same company in the year preceding the accounting period in which the loss is incurred; and
(d) against any profits of other companies in the same group in the same accounting period.

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Trading losses may be set off under (c) against profits of whatever kind falling within the period (duly apportioned, if necessary), first against the profits of the most recent relevant accounting period and, if relevant, against the profits of earlier periods. In order to claim this relief, the company must have been carrying on the trade in respect of which the loss is claimed during the accounting period in question.

From 1 April 2017 the offset of losses brought forward is restricted to 50% of the annual profits of the relevant trade in the relevant period. There is however, a £5 million annual allowance and thus the 50% restriction only applies to profits over the first £5 million. The 50% restriction will, therefore, not usually have an impact on SMEs.

The £5 million allowance applies on a group basis and must be allocated between group members. Groups are effectively, given the freedom to determine how the allowance is allocated.

An election to claim relief under CTA 2010, s 37 has to be made within two years immediately following the accounting period in which the loss was incurred or within such further period as HMRC may allow.

Post-31 March 2017 losses

Trading losses arising on or after 1 April 2017 may be set off in the following ways:

(a) against any profits of the same company for the same accounting period;
(b) against any profits of the same company in subsequent accounting periods, without time limit;
(c) against any profits of the same company in the year preceding the accounting period in which the loss is incurred;
(d) against any profits of other companies in the same group in the same accounting period; and
(e) against any profits of other companies in the same group in subsequent periods, without time limit.

The new rules are therefore more generous and flexible. Again, though the annual profits that can be relieved by carried forward losses are limited to 50% of such annual profits, but subject to the £5 million allowance. From 1 April 2020, capital losses brought forward will be subject to the same 50% restriction, but again the £5 million allowance will be available.

Also note from 1 April 2017 trading losses can still only be carried forward and offset against profits of the same trade where:

(a) the trade became small and negligible in the period that the loss arose;
(b) relief was unavailable in the year that the loss arose because of certain specified exclusions, trade carried on wholly abroad, trade not carried on a commercial basis, losses of a separate film trade in a pre-completion period; or
(c) relief would be unavailable in the period of the claim as in that period the trade was not run commercially.

Certain industries are subject to slightly different rules in connection with the loss rules. These are banks, life assurance companies, oil and gas activities,

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creative industries companies (film, TV, video games and orchestras), REITS and furnished holiday lettings. There are also some special rules relating to Northern Ireland.

For most purposes, the transfer of shares in a target company in an arm's length transaction has no effect on the target's tax position. Under CTA 2010, Part 14, however, relief under s 45 (carry-forward of trading losses) is not to be given by setting a loss incurred by the company in an accounting period beginning before the change of ownership against any income or other profits of an accounting period ending after the change of ownership where:

(a) within any period of three years there is both a change in the ownership of a company and (either earlier or later in that period, or at the same time) a major change in the nature or conduct of a trade carried on by the company; or
(b) at any time after the scale of activities in a trade carried on by the company has become small or negligible, and before any considerable revival of the trade, there is a change in the ownership of the company.

This was further extended by FA 2013, see **2.2**.

Where both the change in ownership and the major change in the nature and conduct of trade occur on or after 1 April 2017 the three-year time frame is extended to five years although that period cannot commence at a time more than three years before the change in ownership.

CTA 2010, Part 14 prevents the carry-back under s 37 of trading losses incurred after a change of ownership reducing profits earned before the takeover, where there has been in any period of three years including the change of ownership a major change in the nature or conduct of the trade carried on by the company whose ownership has changed. Again where both the change in ownership and the major change in the nature and conduct of trade occur on or after 1 April 2017 the three-year time frame is extended to five years although that period cannot commence at a time more than three years before the change in ownership.

For the purposes of Part 14, the accounting period of the target running at the date of the acquisition is split into two on that date (s 674(3)) and the necessary apportionment of profits or losses is to be on a time basis, unless it appears that that method would work unreasonably or unjustly, when such other method is to be used 'as appears just and reasonable' (s 674(5)).

CTA 2010, Part 14 also prevents the use of surplus management expenses of an investment company accumulated before the change in its ownership from being carried forward and set against investment income and gains generated after the change in ownership, if:

(a) within the six years beginning three years before the change in ownership there is a major change in the nature or conduct of the company's business; or
(b) the scale of its activities became small or negligible before the change and revived after it; or
(c) the company's capital is significantly increased in the year before or the three years after the change in ownership; or

(d) after the change in ownership the company acquires an asset from another company under TCGA 1992, s 171(1) (no gain/no loss transfer) and realises a chargeable gain on the asset within the three years beginning with the change in ownership.

The aim is to prevent the use of surplus management expenses in an acquired company from sheltering investment income and gains after the change in ownership and again the law was further strengthened by FA 2013. From 1 April 2017 the rules apply to five not three years after the change in ownership so the overall period is extended from six to eight years but only where both the change in ownership and the major change take place on or after 1 April 2017.

Similar provisions (again in Part 14) apply in relation to changes in the ownership of a company carrying on a property business.

'Major change in the nature or conduct of a trade' is defined in s 673(4) to include:

(a) a major change in the type of property dealt in, or services or facilities provided, in the trade; or
(b) a major change in customers, outlets or markets of the trade,

and the section applies even if the change is the result of a gradual process which began outside the relevant period mentioned in s 673(2). In *Willis v Peeters Picture Frames Ltd* 56 TC 436 it was held that the relevant circumstances to be considered were essentially matters of fact. In *Purchase v Tesco Stores Ltd* 58 TC 46 it was indicated that the word 'major' imported something more than 'significant' but less than 'fundamental' – the *effect* of the change should also be considered.

In June 2016, HMRC published a revised Statement of Practice SP 10/91, setting out their view of what constitutes a major change in the nature or conduct of a trade (or, as appropriate, business).

Where a hive-down has occurred prior to the change in ownership, s 676 will prevent the losses incurred by the predecessor company from being carried forward for use by the successor (ie the target) company. However, it would seem that, in the reverse situation, (ie where a trade is hived down from the target *after* the change of ownership) the provisions of Part 14 will not apply since there has been no change of ownership of the successor company. Accordingly, if there is uncertainty as to whether there will be a major change in the nature or conduct of the target's trade after acquisition, it should be considered whether the trade should be transferred immediately to another company in the acquiring group.

A further restriction is introduced by the Finance (No 2) Act 2017 on losses carried forward (CTA 2010, s 676AA). This applies where there are both a change in company ownership and a major change in the business of the company or of a co-transferred company's business on or after 1 April 2017. The rules apply where a major change in a trade takes place within five years of the change in ownership or where a major change in an investment business takes place within eight years of the change in ownership. A major change in the business encompasses all aspects and includes:

(a) a major change in the type of property dealt in, or services or facilities provided in, the trade or business concerned;
(b) a major change in customers, outlets or markets of the trade or business concerned; or
(c) a major change in the nature of the investments held by the company for the purposes of an investment business.

Where this occurs one needs to identify the 'affected profits'. These are the profits arising within five years of the end of the accounting period in which the change in ownership occurred that can fairly and reasonably be attributed to the major change. The brought forward losses arising before the change in ownership cannot be offset against the affected profits arising after the change in ownership. This restriction does not apply to losses arising before 1 April 2017.

A co-transferred company means any company which is related to the transferred company both immediately before and after the change in ownership. They are broadly related if they are members of the same group or consortium.

As trading losses arising on or after 1 April 2017 can be carried forward and offset against all profits they can be offset against future chargeable gains. However, if after there is a change in ownership of a company there is an inter-group transfer at nil gain/loss and that asset is subsequently sold by the company (or a gain is attributed to the company under TCGA 1992, s 171A) within five years of the change in ownership there will be a restriction on the utilisation of the trading losses brought forward from before the change in ownership.

HMRC has extensive information powers in relation to the beneficial ownership of shares or securities under these provisions (s 728). They may also issue assessments within six years of the occurrence of a relevant event (s 727). Accordingly, an assessment can be issued up to nine years after a change in ownership in some cases.

The ability of the vendor to escape liability for a subsidiary's corporation tax liabilities after a sale has been limited by CTA 2010, ss 710–715 in circumstances similar to those which trigger the loss of carry forward relief under s 673. This is considered in more detail in **Chapter 53 Selling a Company**.

CTA 2010, s 432 et seq restricts the utilisation of losses on acquisition of leasing companies. These measures are designed to counter certain planning arrangements and are not intended to cover genuine commercial transactions. Nonetheless care will need to be taken to ensure that no disadvantages occur.

Corporation tax groups for capital gains

[2.48] As mentioned at **2.15**, intra-group transfers between companies within a capital gains group take place on a no gain/no loss basis (TCGA 1992, s 171). A company (the 'principal company of the group') and all its 75% subsidiaries form a group and, if any of those subsidiaries have 75% subsidiaries, the group includes them and their 75% subsidiaries and so on, but a group does not include any company (other than the principal company

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of the group) that is not an 'effective 51% subsidiary' of the principal company of the group. A company cannot be a member of more than one group and there are provisions for resolving which group it is a member of, in the event that it would otherwise be a member of more than one group.

A company is an 'effective 51% subsidiary' of another company at any time if both:

(a) the parent is beneficially entitled to more than 50% of any profits available for distribution to equity holders of the subsidiary; and
(b) the parent would be beneficially entitled to more than 50% of any assets of the subsidiary available for distribution to its equity holders on a winding-up.

CTA 2010, Part 5, Chapter 6 (formerly ICTA 1988, Sch 18) elaborates this test, and provides that 'arrangements' under which entitlement to profits or assets could vary in the future are treated as if they had already happened. Following *J Sainsbury plc v O'Connor* 64 TC 208, further provisions were added, the effect of which is to treat all rights over shares (eg options) as exercised at the earliest possible date. A number of additional tests now have to be satisfied, and in each case the test giving the lowest percentage interest in assets or profits to the putative parent company is the one to be taken.

Purchased gains or losses

[2.49] TCGA 1992, s 16A provides for the disallowance of a capital loss where it is incurred by reason of 'arrangements' that have the securing of a tax advantage as the main or one of the main purposes. The provisions of TCGA 1992, ss 184A–184J further restrict the relief available for capital losses where these are associated with a change in ownership. These provisions are complex and care must be taken where there is a change in ownership and capital losses are in point.

Exit charges

TCGA 1992, s 179

[2.50] Prior to FA 2011, TCGA 1992, s 179 provided that if a company ('the target') ceased to be a member of a group of companies, corporation tax on chargeable gains was to be paid by the target (called 'the chargeable company') in respect of any asset which the target acquired from any other company in its old group within six years ending with the time when the company ceases to be a member of its old group. Where the target company ceases to be a member of the group on or after 19 July 2011 TCGA 1992, s 179(3D) provides for the de-grouping gain or loss to be dealt with by way of adjustment to the gain or loss of the company making the disposal rather than the target company.

The de-grouping charge does not generally apply to intra-group transfers of assets between companies which leave one group together and remain grouped for capital gains purposes, although they need to be in the same group at both the time of intragroup transfer and exit (TCGA 1992, s 179(2)). Relief against

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the exit charge under TCGA 1992, s 179(3) is also given under ss 179(5)–(8) where a company ceases to be a member of a group by reason only of the fact that the principal member of the group becomes a member of another group. The law in this area is complex and needs to be read carefully.

Under TCGA 1992, s 179(3A), where the disposal falls within the substantial shareholdings provision the de-grouping adjustment will follow the same treatment. Additionally, TCGA 1992, Sch 7AC, para 15A provides for the substantial shareholdings exemption to apply in situations involving the disposal of a group's trading activity that has been transferred to another company in the group.

Under TCGA 1992, s 179 there are provisions to cover the situation where a company which has ceased to be a member of a group of companies ('the first group') has acquired an asset from another company which was a member of the first group at that time and that company has left the first group together with the transferor of the asset. Where the company subsequently ceases to be a member of another group of companies ('the second group') and there is a connection between the first and second groups, TCGA 1992, s 179 applies in relation to the company's ceasing to be a member of the second group as if it had been the second group of which both companies had been members at the time of the acquisition. 'Connection' is defined specially for the purposes of this section.

Under TCGA 1992, s 171A, where a deemed gain arises under s 179(3), elections may be made by the company in which the gain arises and any other company (or companies) in the group at the relevant time. The election takes effect for the elected company by treating it as if the gain had accrued there rather than in the original company.

Intangible assets

[2.51] CTA 2009, Part 8, ss 780–799 provide for recognition of a taxable credit or deductible debit on intangible assets in parallel with the previous capital gains de-grouping provisions in TCGA 1992, s 179. FA 2011 made no changes to these rules and so any charge arising continued to be a liability of the target company. However, following the changes in FA 2019 where a company leaves a group on or after 7 November 2018 by way of a share disposal that qualifies for Substantial Shareholders Exemption no de-grouping charge will now arise (FA 2019, s 26; CTA 2009, s 782A).

The legislation provides that where the company leaving the group, or an associated company also leaving the group, still holds the intangible asset, the first company is treated as if it had sold and reacquired the asset immediately after the transfer for its market value at that time. The adjustments for tax purposes for earlier accounting periods as a result of the market value sale and reacquisition are aggregated and brought into account as if they had arisen immediately before the transferee company left the group.

For capital gains purposes generally a de-grouping calculation is necessary not only where an asset, transferred on no gain/no loss terms, is held by a company leaving a group but also, by virtue of TCGA 1992, s 179(3), where the asset held by the company leaving the group is not the asset transferred but another

asset used to frank a gain arising on the disposal outside the group of the first asset under the capital gains roll-over relief rules.

Roll-over relief

[2.52] Careful attention needs to be given to claims for roll-over relief under TCGA 1992, ss 152–158, if, for instance, assets have been disposed of prior to the target's acquisition by the purchaser and a claim for roll-over relief is to be made by the target on assets acquired by other members of the old group. Under TCGA 1992, s 175 all the trades carried on by members of a group are for these purposes to be treated as a single trade. Clearly, there must be an agreement between the vendor and the purchaser as to the allocation of roll-over relief.

Another problem which may emerge is a liability to capital gains tax on the disposal of an asset the gain in relation to which was rolled over into a depreciating asset (TCGA 1992, s 154).

The contingent liabilities created by roll-over relief provisions are potentially very significant and require the purchaser to take great care in his pre-acquisition enquiries to find out the past history of the target's assets.

In a Statement of Practice (D19) published by the CCAB on 10 January 1978, the Inland Revenue stated that the company making the claim for roll-over relief and the company acquiring the asset into which the gain is rolled over must be members of the same group (as defined in TCGA 1992, s 170(10)) when the transaction was carried out. Thus, if company A makes a gain at a time when it is a member of the X group of companies then that gain may be rolled over against an acquisition by company B, if at the time of that acquisition, company B is a member of the X group. Therefore, company B need not have been a member of the X group at the time that company A made the disposal but it must be a member of that group by the time that company B makes its acquisition. Similarly, company A must be a member of the X group at the time that it makes its disposal but need not be a member of the X group at the time that company B makes the corresponding acquisition.

The scope of this practice was extended by Extra-statutory Concession D30, which was as follows:

> 'For the purposes of [TCGA 1992, ss 152 to 158] (replacement of business assets) all the trades carried on by members of a group of companies are treated as a single trade ([TCGA 1992, s 175]). The Inland Revenue are prepared to accept that for the purposes of section [175] companies holding assets used for trade purposes by trading companies within the group shall be treated as trading companies. This treatment applies even if the company also holds assets used by non-group members although relief is only available in respect of those assets used by group members.'

This whole approach was thrown into doubt by remarks of Knox J in *Campbell Connelly & Co Ltd v Barnett* 66 TC 380, which prompted the Financial Secretary of the Treasury to say:

> ' . . . In the light of Mr Justice Knox's judgment it is clear that the Revenue's established practice in relation to rollover relief and groups of companies is probably based on an incorrect understanding of the law. The Revenue's practice

> seems to me to be sensible and to reflect how commercial transactions are commonly organised. We will ensure that it continues to apply.' (Inland Revenue Press Release 15 September 1992).

TCGA 1992, s 175(2A) provides statutory authority to HMRC's practice of allowing a gain on disposal of an asset by one company in a group to be rolled over into an acquisition by another company in the group. This section also prevented what was known as 'roll-around' relief, which occurred where a group company claimed roll-over relief on assets acquired on a no gain/no loss basis from other group companies.

CTA 2009, s 754 provides for a form of roll-over relief on goodwill and intangible assets, enabling some or all of a taxable credit arising on the realisation of an intangible asset (including goodwill) to be deferred. The relief works by deducting the credit from the company's expenditure on other qualifying intangible assets, thereby reducing the deductible debits for sums written off those assets.

Relief may also be available where the reinvestment is made by another group member and where the reinvestment is in the shares of another company which becomes a group member as a result (see below). The relief is not available where a taxable credit arises on the part realisation of an asset where the person acquiring the interest in the asset is a related party.

Capital gains on the disposal of goodwill and intangible assets which are existing assets (and outside the CTA 2009 legislation by virtue of the commencement rules) may also be rolled over against expenditure on qualifying assets.

There are various conditions to be met for the relief to be available:

(a) The asset on which the credit arises (the 'old asset') must have been an asset within the computational rules of CTA 2009, Part 8. The relief is not restricted to assets used for a trade, but an asset must be used for business or other commercial purposes if it is to qualify in the first place. There is a special apportionment rule for assets which do not meet this requirement throughout the period of ownership.
(b) The proceeds of realisation of the old asset must exceed its cost recognised for tax purposes. There are specific rules for part realisations.
(c) The new expenditure must have been incurred in the period extending from twelve months before to three years after the time the old asset is realised, subject to any extension of the time limits in a particular case allowed by HMRC. The period allowed for reinvestment is similar to that under the capital gains roll-over provisions, but the date an asset is realised will be the date it ceases to be recognised for accounting purposes. Similarly, the date expenditure is incurred on the new assets will be the date it is recognised for accounting purposes (see CTA 2009, s 756(4)).
(d) Only capitalised expenditure can be taken into account (rather than expenditure written off as incurred). However, where an intangible asset which meets the requirement that it must be a fixed asset is

unexpectedly sold shortly after acquisition, the fact that it has never appeared in a company's balance sheet drawn up at the end of a period of account would not prevent the expenditure from being regarded as capitalised.

(e) The assets in question must be chargeable intangible assets immediately after the expenditure is incurred.

(f) No relief will be available unless the expenditure on other assets exceeds the cost recognised for tax purposes of the old asset.

A claim by a company under the provisions must specify the old assets to which the claim relates and, in relation to each old asset, the expenditure on other assets leading to the deferral and the amount of relief claimed.

The basic rule is that the proceeds from the realisation of the old asset and the expenditure on other assets are both reduced by the amount available for relief. Where the expenditure on other assets exceeds the realisation proceeds of the old asset the amount available for relief is the excess of the proceeds over the cost recognised for tax purposes of the old asset. Where the expenditure on other assets is less than the realisation proceeds the amount available for relief is limited to the excess of the expenditure over the cost recognised for tax purposes of the old asset.

Additionally, there are provisions for claims within a group, broadly similar, but not identical, to those for capital gains.

Roll-over relief is extended to the case where expenditure on new assets is incurred by a company which is a member of the same group as the company realising the old assets (CTA 2019, s 777). Where the specified conditions are satisfied, the company realising the asset and the company incurring the expenditure on the new assets are treated as if they were the same company.

Broadly, the conditions for this treatment are as follows:

(a) a company must be a member of a group at the time it realises the old asset;

(b) the expenditure on other assets must be by another company which at the time of the acquisition is a member of the same group (though there is no requirement that companies have to be members of the same group simultaneously);

(c) the company incurring the expenditure must not be a dual-resident investing company;

(d) the new assets must be chargeable intangible assets immediately after the expenditure is incurred; and

(e) the claim must be made by both companies.

Expenditure on acquiring assets from another group member by way of tax-neutral transfer is not available for roll-over relief.

Similarly, the acquisition of a group company is treated as equivalent to an acquisition of qualifying assets where there are underlying qualifying intangible assets. Those assets may be held by the company itself or by another company (normally a subsidiary of the first) so long as the company in question, as a result of the acquisition of the shares, becomes a member of the group to which the company acquiring the shares belongs. The provisions

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apply by treating the acquisition by a company of a controlling interest in another company as expenditure on acquiring 'underlying' intangible fixed assets. The underlying assets may be those held by the company acquired or by another company which became a member of the group as a result of the acquisition.

Finally, the legislation permits the deemed realisation of an asset under the de-grouping rules to be the subject of a roll-over relief claim.

Group relief

[2.53] 'Group relief' is the term for the range of reliefs under which a company in a group ('the surrendering company') allows another company in the same group ('the claimant company') the use of its current trading losses, non-trading deficits under the loan relationship legislation, capital allowances, excess management expenses of investment companies and excess charges on income to reduce its liability to corporation tax. Group relief also applies to certain consortium situations.

The payment of any sum for group relief is, under CTA 2010, s 183(2) not to affect the computation of profit or losses of either company for corporation tax purposes or to be treated as a distribution or a charge on income.

The material aspects in relation to a takeover are as follows:

(a) When are companies in the same group?
(b) What happens when a company joins or leaves a group?
(c) What amount is eligible for group relief?

Taking these in turn, the position is as follows.

When are companies in the same group?

[2.54] Two companies are members of the same group for group relief purposes if one is a 75% subsidiary of the other or both are 75% subsidiaries of a third company. Group relief is available to non-UK resident companies carrying on a trade in the United Kingdom through a branch or agency. Shares owned directly or indirectly do not count if a profit on their sale would be a trading receipt of the direct owners.

For group relief purposes, the parent must be entitled to not less than 75% of any profits available for distribution to equity holders of the subsidiary company and to not less than 75% of any of its assets available for distribution to its equity holders on a winding up. For this purpose an equity holder of a company is any person who holds ordinary shares in a company or is a loan creditor of the company in respect of a loan which is not a normal commercial loan.

The provisions for group relief also apply to companies involved in a consortium if the relevant companies are resident in the United Kingdom and either one of them is a member of a consortium and the other is (a) a trading company which is owned by the consortium and which is not a 75% subsidiary of any company, or (b) a trading company which is a 90%

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subsidiary of a holding company which is owned by the consortium and which is not a 75% subsidiary of any other holding company, or (c) a holding company which is owned by the consortium and which is not a 75% subsidiary of any company; or, in accordance with CTA 2010, s 133, where one of them is a member of a group of companies and the other is owned by a consortium and another company is a member of both the group and the consortium.

In *Marks & Spencer plc v Halsey* C-446/03 the company claimed to offset losses made by its EU resident subsidiaries against profits made by UK resident group companies and took their argument to the ECJ. The judgment by the ECJ was that the UK group loss relief rules are in principle compatible with European law but went too far in denying loss relief to a parent company for the losses of a foreign subsidiary where the parent company has demonstrated that the subsidiary has exhausted all possibilities of relief in its state of residence. The UK legislation was therefore amended (in FA 2006, Sch 1) to provide an extension to the rules that give relief for losses and other amounts within groups of companies to cover all companies in the EEA on the above principle. These changes have applied since 1 April 2006, though anti-avoidance provisions were introduced effective from 20 February 2006 to deny relief where arrangements are in place that result either in losses becoming unrelievable outside the UK that would otherwise not be so or give rise to losses that would not have arisen without the relief in the UK. The compliance of the provisions with EU community law is still to be confirmed. Of course, going forward, one of the potential consequences of a hard Brexit would be that the Government could chose to have group relief rules that are not EEA compliant.

What happens when a company joins or leaves a group?

[2.55] Under CTA 2010, s 138 et seq when a company joins or leaves a group, relief for losses claimed by a company are restricted to the profits of the claimant company attributable to the overlapping period, though there is greater flexibility from 1 April 2017 (see **2.57**). The profits or losses or other amount eligible for relief for the overlapping period are apportioned on a time basis. The pure time-related basis of apportionment can be displaced if it appears that that method would work unreasonably or unjustly, in which case such other method is to be used as appears just and reasonable (CTA 2010, s 141).

Arrangements and beneficial ownerships

[2.56] Detailed rules governing the treatment for these purposes of arrangements for the transfer of a company from one group to another are set out in CTA 2010, ss 154–156.

The former Inland Revenue's views on this legislation were set out in Statement of Practice SP 5/80, the material part of which is as follows:

> 'No comprehensive statement of what constitutes "arrangements", or when they first come into existence, can be given: both must depend on the whole of the relevant facts. In particular, in the Board's view an arrangement may exist between parties even though it is not enforceable.

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> Subject to that overriding caveat, the following comments as to the way in which Inspectors may be expected to approach section 410 [now CTA 2010, s 154] problems in practice may be helpful. Inspectors do not normally find arrangements in existence in the case of a straightforward sale of a company before the date of the acceptance (subject to contract or on a similar conditional basis) of the offer unless there is some unusual feature about the negotiations. Equally, unless there are some exceptional circumstances, a genuine offer made to the public at large of shares or a business does not bring arrangements into existence.
>
> When a sale of a subsidiary company or similar transaction in shares requires the approval of the shareholders, it is considered that no arrangement will come into existence until that approval has been given, or the company's officers are aware that it will be given.
>
> Where a potential vendor is actively negotiating with a prospective purchaser, the mere fact that he does not pursue alternative offers would not be regarded as bringing an arrangement into existence. However, an offer to a particular potential purchaser, which by common understanding is allowed to remain open for an appreciable period, thus enabling that potential purchaser to choose his moment during that period to create a bargain, could be regarded as akin to the grant to that potential purchaser of an option. If there was such an understanding in existence that the offer should be kept open (which would normally be after the offer was formally made, but might in some circumstances be before) the Inspector may contend that an arrangement came into existence at the time this understanding was reached.
>
> In general the fact that negotiations have broken down is a strong indication that they did not reach a stage which brought arrangements into existence.'

This was then replaced by Statement of Practice SP 3/93 and a revised Extra-statutory Concession C10. The later Statement of Practice indicates that:

> 'Some features of [SP 5/80] have been omitted or revised but this does not indicate a more restrictive approach on the part of the Inland Revenue.'

Extra-Statutory Concession C10 was enacted within CTA 2010, ss 155A, 155B, 174A and 174B for accounting periods beginning on or after 1 March 2012.

The law has been considered in three cases, *Pilkington Bros Ltd v IRC* 55 TC 705, *Irving v Tesco Stores (Holdings) Ltd* 58 TC 1 and *J Sainsbury plc v O'Connor* 64 TC 208. In the first of these, the House of Lords held that 'arrangements' were in effect so that a 75% holding company was prevented from controlling its subsidiary within the meaning of what is now CTA 2010, s 1124 by virtue of its articles of association. The Court had to look at the effect of the arrangements and not their purpose. In the *Tesco* case, Walton J held that for the purposes of the test of control in what is now CTA 2010, s 1124, what mattered was the effect of the arrangements and not the extent to which they had been implemented.

In the *Sainsbury* case, Millett J (in the High Court) had to consider two separate aspects: (a) beneficial ownership of the shares in question; and (b) whether there were 'arrangements' in place for the purposes of what is now CTA 2010, ss 169–182. He held that as the option agreement in that case was not a relevant 'arrangement' within the meaning of paragraph 5(3) (now

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s 169), group relief was not to be denied. Sainsbury owned 75% of the shares of a joint venture company and its partner 25%. It had always been intended to be a 70/30 relationship, but the structure was designed to allow Sainsbury to obtain group relief. 5% of Sainsbury's shares were subject to cross-options at a formula price for a period exceeding four years, but neither of the options were exercised and indeed at the end they were cancelled. Consortium relief was not sought as the minority shareholder was not a UK resident company.

The effect of the *Sainsbury* case has been reversed by CTA 2010, ss 169–182, which brings into the tests which have to be satisfied not only rights to income or assets which may vary, but also a deeming that all rights in or over shares, eg options, have been exercised at the earliest possible date.

A practical point to be considered is that a claim to group relief can be made after the sale takes place (see *A W Chapman Ltd v Hennessey* 55 TC 516, a case concerning the position before s 154 et seq came into operation). This case also illustrates the need to deal with the question of losses being carried forward to the new group or surrendered within the old group expressly by the time of sale. The vendor asked the target to execute the claim for surrender of pre-sale losses to the vendor's group some months after the sale took place and HMRC accepted the surrender. Subsequently, the target claimed to carry forward the same losses, contending that in order to be effective two companies had to be members of the same group when the claim for group relief was made as well as during corresponding accounting periods. The target's arguments were rejected by Nourse J. In this case, the accounts of the target showed that group relief would be claimed, but no evidence could be found that the question of tax losses had been discussed in sale negotiations.

What amount is eligible for group relief?

[2.57] Having determined when the target left its first group and joined its second group, it is then necessary to determine the sums eligible for relief. There are two aspects: the common period for which the appropriate amount of relief is to be applied to the appropriate amount of profit, and the substance of the reliefs themselves.

If the accounting period of the surrendering company and the claimant company do not coincide (either because they do not draw up accounts for the same period or because one or other or both are not members of the same group throughout the relevant accounting periods) the amount which can be set off is limited to the smaller of the unused losses of the surrendering company and the unrelieved profits of the claimant company for the period during which their accounting periods overlap (CTA 2010, s 139).

One area which had been a matter of doubt was resolved by *Shepherd v Law Land plc* 63 TC 692. It had long been argued by HMRC that the existence of arrangements at any time during an accounting period would result in the company losing the right to surrender by way of group relief under CTA 2010, Part 5, Chapter 4 the trading losses and other amounts eligible for group relief for the whole of that accounting period. This case determined that the period in respect of which such amounts could not be surrendered was the period from the time that the arrangements began until they terminated (whether by

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way of completion of the sale or otherwise), and not any longer period. In almost every case, there will be a need to apportion the losses incurred whilst the arrangements subsist. Accordingly, in order to maximise the value of tax losses it will be critical to determine the dates on which arrangements began and ended.

In brief, the reliefs which are eligible for group relief under CTA 2010, Part 5 are as follows:

(a) trading losses as computed;
(b) some capital allowances, ie those which attract relief through the reduction of tax rather than being treated as trading expenses, limited to the extent that they exceed the income of the relevant class;
(c) expenses of management in excess of an investment company's profits;
(d) excess charges on income;
(e) non-trading deficits arising under the loan relationship legislation; and
(f) property business losses.

A company can now surrender losses brought forward from previous years against total profits but only where those losses arose on or after 1 April 2017. The following however, cannot be surrendered:

(a) a non-trading intangible loss carried forward to the surrendering period if an investment business carried on by the surrendering company became small or negligible before the beginning of that period;
(b) surplus management expenses carried forward to the surrendering period if an investment business carried on by the surrendering company became small or negligible before the beginning of that period;
(c) UK property business losses carried forward to the surrendering period if an investment business carried on by the surrendering company became small or negligible before the beginning of that period.

Companies with no assets capable of producing income cannot surrender carried forward losses thereby preventing the retention of otherwise dormant companies in order to access their losses.

In addition, a company cannot claim group relief for losses from a company that was acquired by the group where the losses arose before the potentially surrendering company was acquired. This restriction only applies for a period of five years following the end of the accounting period of the acquired company in which the change of ownership arose.

The brought forward losses can only be surrendered by a company in a particular accounting period to the extent that those losses cannot be relieved against its own profits in the same accounting period.

The losses brought forward and surrendered are subject to the 50% rule and £5 million allowance detailed in **2.47**.

Other investor reliefs

[2.58] The reliefs for Venture Capital Trusts and for individuals under the Enterprise Investment Scheme and the Seed Enterprise Investment Scheme may

also be relevant following the acquisition and should certainly be considered. These reliefs are set out in details at **Chapter 17 Enterprise Investment Scheme** and **Chapter 65 Venture Capital Trusts**.

Potential investor pitfalls

[2.59] A Special Commissioner's decision, *Bird v Revenue and Customs Comrs* [2009] STC (SCD) 81, acts as a reminder that HMRC will use the settlements legislation where considered appropriate. In this case a company was owned by a husband and wife and there was an allotment of shares in the company to their minor children on subscription at par followed by payment of dividends. It was held that the permission to subscribe for the shares amounted to a settlement, which meant the dividends were taxable on the parents. It is, therefore, important to look carefully at all aspects of tax when setting up shares in a new company.

Similarly in *Donovan and McLaren v Revenue and Customs Comrs* [2014] UKFTT 048 (TC), HMRC contended that there was no commercial purpose to the dividend waivers, the company had insufficient reserves to pay the dividends if there had been no waivers, the intention was to pay higher dividends to the directors' wives, and the waivers and payment of dividends constituted an 'arrangement' under the settlements legislation in s 620 of the ITTOIA 2005. The Tribunal agreed with HMRC.

Conclusion to buying a company

[2.60] This chapter has discussed the tax aspects of the sale of a company from the point of view of the purchaser. For a view of the vendor's tax position, see **Chapter 53 Selling a Company**.