A hive of activity

Large Corporate



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Jack Hollyman considers how to manage the commercial and tax issues when transferring business assets and shares to a purchasing company

Key Points

What is the issue?

The implementation of a hive down is often far more complex than it might seem at the planning stage. When combined with an M&A transaction, an adviser must consider a number of issues across several different tax codes.

What does it mean for me?

It is all too easy for the unwary to solve one tax issue and inadvertently cause another.

What can I take away?

Hive downs in preparation of an M&A transaction provide an opportunity for tax advisers to demonstrate their commerciality alongside complex tax technical input. But thorough planning at the outset is critical.

It always sounds so simple: ‘Hive down the trade and assets into a new company (‘Newco’) and dispose of Newco to a buyer, tax free’. But, of course, there are a host of commercial and tax issues to consider and navigate. The commercial aspects of a hive down, while burdensome, are generally well understood and managed upfront. For example, some of the key commercial areas of focus are:

- Can employees be transferred (and do they want to be!)?
- Are the employees who are transferring to Newco currently part of a seller group incentive plan (perhaps a share plan) that needs to be restructured or monetised?
- Can customer contracts, supplier contracts, leases, insurance policies, etc., transfer to Newco without requiring third party permissions or without giving the counterparty of the contract a chance to renegotiate existing favourable terms?
- Does there need to be a transitional services agreement with the seller to allow Newco to operate in the period after the hive down until it establishes its own operational infrastructure?
- Do any regulatory requirements prevent Newco from trading until authorisations are given to Newco (common in the pharmaceutical sector)?

The tax implications for each of the above need consideration; however, this article focuses on the hive down itself and the execution of the sale of Newco to a third party buyer (‘Buyer’). The commentary below assumes that the transferor of the trade and assets (‘Transferor’) and Newco are both UK tax resident companies.

Succession of trade

A key area to consider is whether the hive down of the trade falls within the (mandatory) ‘succession of trade’ provisions. If it does, the trade is (broadly) treated as if it was always carried on by Newco (e.g. plant and machinery transfer at tax written down value, brought forward tax losses transfer to Newco, etc.).

For these rules to apply, the ‘ownership condition’ and the ‘tax condition’ must be met.

For the ‘ownership condition’ to apply:

- at the time of the transfer of the trade, or at some time during the period of two years beginning immediately after the transfer, a 75% interest in the transferred trade must belong to certain persons; and
- at some point in the time during the period of one year ending immediately before the transfer, a 75% interest in the transferred trade must have belonged to the same persons.

Broadly, this means the trade must have been carried on under the same 75% common ownership both before and after the hive down.

The ‘tax condition’ requires that, in effect, the trade remains in the UK tax net (corporation tax or income tax). Often, a hive down is undertaken to facilitate an M&A transaction. This can pose interesting beneficial ownership complexities as it is critical that Newco carries on the trade while under the beneficial ownership of Transferor.

Helpfully, HMRC provides some useful commentary on this area in CTM06030. The manual states that:

> ‘Beneficial interest in shares normally passes from vendor to purchaser when an unconditional sale document is signed. But if a contract is subject to a condition precedent, then beneficial ownership does not pass so long as the condition remains unfulfilled.
>
> ‘On the other hand, the legal owner can lose the beneficial interest in shares by entering into an unconditional agreement to sell them in advance of signing a contract. An oral agreement can be an unconditional agreement.’

Hive downs followed by a sale to a third party are therefore generally executed through the following documents:

- an asset transfer agreement entered into between Transferor and Newco;

- a put-call option agreement (PCOA) entered into between Transferor and Buyer; and
  a short-form share purchase agreement effecting the transfer under the PCOA, entered into between Transferor and Buyer.

The PCOA is in effect the equivalent of an unconditional contract for sale; however, as covered in J Sainsbury Plc v O'Connor [1991] STC 318, the existence of options should not affect beneficial ownership.

There is no strict period that Newco should trade for whilst under the beneficial ownership of Transferor; however, the longer the period, the greater the comfort. In practice, a month is considered a reasonable amount of time, but it is not unusual for this to be reduced. This point was considered in Barkers of Malton Ltd v HMRC [2008] SpC 689.

There can also be some wrinkles when the transferor is in the process of being wound up. A company in liquidation ceases to be the beneficial owner of its assets (including subsidiary shareholdings). As a result, the 'succession of trade' rules should not apply when a company in liquidation transfers a trade. Conversely, HMRC confirms in CTM06030 that a company to which a receiver or administrative receiver is appointed does not lose the beneficial ownership of shares it owns in other companies.

Consideration for the hive down

In the example, Buyer might be tempted to request that Transferor transfers the trade and assets in exchange for a loan note or with the proceeds left outstanding (i.e. a loan). This would reduce the equity value of Newco to a nominal amount and therefore reduce the stamp duty payable by Buyer on the acquisition of Newco shares. Great! But wait: if Buyer acquires the Newco shares for, say, £1, and warranties and indemnities are provided to Buyer by Transferor, the receipt by Buyer of any such payments could be taxable as it is not possible to adjust the purchase price (i.e. in accordance with ESC D33) to a negative base cost. See 'Stay out of the beartraps' by Alistair Goodwin (Tax Adviser, November 2019).

Intragroup transfers of assets and the substantial shareholding exemption

The tax implications of a transfer of assets, and subsequent de-grouping events, are no doubt familiar to readers (see 'Hive downs' by James Tryfonos (Tax Adviser, May

2019)) – even if, like me, practitioners may have to refresh their memories each time about which provisions apply to which transfers based on applicable dates, underlying asset classes, etc. Nevertheless, the tax treatment of intra-group asset transfers would require its own lengthy article and so they are not covered here.

Provided that the conditions of the substantial shareholding exemption (SSE) are met, any gains (or losses) arising to Transferor on the disposal of Newco to Buyer should be exempt. Problems arise, though, if Transferor was not itself already in a group. This was confirmed recently in M Group Holdings Ltd v HMRC [2021] UKFTT 69, in which the First-tier Tribunal dismissed an appeal against a closure notice denying SSE as a group had not existed for 12 months prior to the disposal.

Consideration should also be given to stamp duty land tax (and potential clawbacks) if the hive down involves the transfer of a property interest.

Value added tax

Often the hive down of a trade should qualify as a transfer of a going concern (TOGC) and therefore be outside the scope of VAT. However, complexity can arise when the transitional services to be provided by Transferor (or its affiliate) until Newco establishes its own operational infrastructure are excessive. For example, if no employees move to Newco, this could put tension on the TOGC treatment. See ‘A grey area of VAT’ by Neil Warren (Tax Adviser, February 2016).

Of course, if Newco carries on a fully taxable business for VAT purposes and the transfer does not qualify as a TOGC, the VAT charged on the transfer should be recoverable resulting in only a cashflow disadvantage. To eliminate the TOGC risk, Newco could be added to Transferor’s VAT group (assuming there is one) prior to the trade and asset transfer, and then be subsequently removed from it on the sale of Newco. Great! Problem solved. But, as is so often the case, one fix causes other problems.

Members of a VAT group have joint and several liability with respect to the VAT group. Adding Newco to Transferor’s VAT group could therefore pass on unwanted VAT risk to Newco, which requires additional (likely reciprocal) indemnity clauses to be added to the transaction legal documentation. In practice, the additional clauses should be uncontroversial as the intention of both buyer and seller should be that Newco is not liable for the VAT position of Transferor’s VAT group, and vice versa.

What can easily be overlooked is that when Newco is removed from the VAT group it no longer has its own VAT number to include on its invoices. It will take time to obtain a VAT number and, technically, Newco should not raise any invoices during this period. Thankfully, HMRC is generally pragmatic in this area.

Conclusion

As with all transaction-related tax advice, it is critical that the commercial objectives are put first, with the tax implications then considered alongside those commercial objectives. If the commercial fact pattern supports a hive down then beware: there are a number of tax issues to consider across a variety of different taxes.