Partnership incorporation: tax relief for goodwill

OMB



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The case of *Armour Veterinary Group Ltd* focuses on tax relief for goodwill under the corporate intangibles regime.

Key Points

What is the issue?

The First-tier Tribunal decision in the case of *Armour Veterinary Group Ltd* focuses on tax relief for goodwill under the corporate intangibles regime, particularly concerning ‘related party goodwill’. The case is significant for its implications on partnership businesses and their incorporation.

What does it mean for me?

The tribunal examined several key points, including the provisions of the intangibles regime, the creation date of goodwill, ownership of goodwill in partnerships, and the application of the Partnership Act 1890. The date of creation was crucial, as related party goodwill created before April 2002 was ineligible for relief.

What can I take away?

The case highlights the importance of having a formal partnership agreement and evidence in partnership businesses to secure tax reliefs and manage goodwill effectively. Without these, partners lose control over how matters are applied, and evidence becomes crucial for tax relief claims.

Farming and veterinary are two industries that still have partnerships at their core. The First-tier Tribunal decision in *Armour Veterinary Group Ltd v HMRC* [2024] UKFTT 539 (TC) was a win for HMRC. The headline issue was tax relief for goodwill and, more precisely, relief under the corporate intangibles regime for ‘related party goodwill’. However, the case has much wider relevance, especially on the conduct of partnership businesses generally, as well as partnership incorporation.

The background

The case was brought by Armour Veterinary Group Ltd (AVGL), a company with the principal activity of a veterinary practice which had claimed a deduction for goodwill in its accounts. The central point in the appeal was whether the goodwill fell within the provisions of the intangibles regime. To the extent that it fell *within* the regime, amortisation relief would be available. To the extent that it fell *outside* the intangibles regime, it was accepted that no relief for amortisation would be available.

It was therefore necessary to consider how the goodwill arose. Some of the goodwill was derived from acquisition of a third party business. The balance arose through successive changes from sole trader practice, to partnership, to company; as employees became partners; and as partners retired as the core business developed.

Related party goodwill would be deemed ineligible for relief where the business in which it was created existed before April 2002. That raised the question of when a

partnership business first arose, and the relations between the parties at each stage. When were they connected parties for the corporate intangibles regime?

The key points

There are a number of key points to consider from this tribunal:

- To what point did the goodwill fall within the provisions of the intangibles regime?
- How did the goodwill come about and what was the date of creation?
- Who owns the goodwill in a partnership? Is it the individual partners or the partnership?
- What is the value of the goodwill?
- The Partnership Act 1890 applies by default. If you don’t want its provisions to apply, it must be specifically ruled out via the partnership agreement.

Corporate intangibles regime and the importance of the date of creation

In this appeal to the First-tier Tribunal, it was necessary to go back to the start of the corporate intangibles regime and understand the detail; in particular, the regime from 1 April 2002 to December 2014, as it applied to related party goodwill (Corporation Tax Act 2009 s 882). The regime has applied in its current form since 1 April 2019 (Corporation Tax Act 2009 ss 879A-879P).

Under the provisions then applying, amortisation was permitted for related party goodwill, provided that the asset was created on or after 1 April 2002. No deduction was available for related party goodwill created prior to this date. Under Corporation Tax Act 2009 s 884(a), the date of creation for goodwill is deemed to be before 1 April 2002, where the business now conducted by a company was previously carried on by a related party.

A key point in this appeal was therefore determining the date of creation. If related party goodwill was created prior to 1 April 2002, or if the goodwill in the company was created in a related party business before that date, there would be no tax relief. As regards third party acquisitions between 1 April 2002 and 7 July 2015, relief

for goodwill would be available.

It was therefore important to establish who sold the goodwill to the company, and who owned the goodwill before the sale. This created a further legal debate. Who owns the goodwill in a partnership? Is it the individual partners, or the partnership? The tribunal then raised a further possibility. A Scottish partnership, unlike partnerships in the rest of the UK, exists as a separate legal entity to the partners. As the partnerships operated in Scotland, did that make a difference? There was a lot to consider.

The history of the business

AVGL was incorporated on 27 January 2014. Its directors are Mr Hewitt and Mr Walker, each of whom hold 50% of its shares. Shortly after incorporation, AVGL acquired the business of that Armoury Veterinary Centre, which was being carried on by Mr Hewitt and Mr Walker in partnership.

Armoury Veterinary Centre's business, prior to its acquisition by AVGL, is set out below:

- The veterinary practice was originally established by Mr Alexander in 1978.
- Mr Hewitt had joined the practice in 1997, becoming a partner in May 2000.
- Mr Alexander retired in April 2005 and Mr Hewitt took over the practice as a sole trader.
- In 2006, Mr Walker joined the business, becoming a partner in August 2008.
- In 2012, a neighbouring practice was acquired. Following the acquisition, goodwill of £165,805 was shown as an acquisition in Armoury Veterinary Centre's accounts.

Following AVGL's incorporation, its initial accounts showed goodwill of £1.875 million, with amortisation charged in the accounts to July 2015. This was then all rolled up into the company goodwill of 2015 on incorporation. The goodwill could have arisen after April 2002, but the business was in existence before then.

Three elements of goodwill

Looking at the evolution of the business, three possible elements of goodwill were identified:

- goodwill on the acquisition of the neighbouring practice by the partnership of Mr Hewitt and Mr Walker in 2012 (the 2012 goodwill);
- goodwill when Mr Walker became a partner in 2008 (the 2008 goodwill); and
- goodwill acquired by Mr Hewitt, when he took over the business from Mr Alexander (the 2005 goodwill).

A large number of partnerships have this type of timeline and complexity.

When was the partnership created?

The veterinary practice changed from being a sole trader to a partnership, back to a sole trade on Mr Alexander's retirement, then to a different partnership and finally to a company.

For the related party rules, it becomes critical when the partnership first existed. Mr Alexander's sole trader practice existed before April 2002. If the business was sold to his successor (Mr Hewitt) while Mr Hewitt was an employee, this would not count as a related party sale. However, if Mr Hewitt was in partnership with Mr Alexander, it would be a related party sale and no deduction would be allowed in the company accounts for goodwill.

To answer this question it is necessary to turn to the Partnership Act 1890 s 1(1). A partnership is: 'the relationship which subsists between persons carrying on a business in common with a view to profit'. Evidence as to the who, what and when of the partners in this particular case was inconsistent. The website, seemingly supported by the tax returns and accounts, said one thing; oral evidence, however, said another.

For AVGL, it was argued that the goodwill acquired by the company in January 2015 was not a pre-2002 asset, as Mr Hewitt was a 'salaried partner' and not a full equity partner until 2005, when Mr Alexander retired.

HMRC took the line that the title 'salaried partner' normally referred to an employee taxed under PAYE, whereas Mr Hewitt had been taxed on a share of partnership profits. Indeed, the AVGL practice website said that Mr Hewitt had been a partner since 1999. In HMRC's view, there was no 'middle way' of being a partner in name only without a stake in the business goodwill, unless the individual was an employee.

No written partnership agreement

As noted below, the tribunal's strong analysis of partnership law concluded that it may be possible to be a partner with limited rights, but only if these are expressly provided for in a legal agreement. Another point of interest was the value to be attributed to the 2005 goodwill. Tax returns included a capital gains tax calculation for disposal of goodwill, calculated 'with reference to standard industry figures for calculating practice goodwill'. There was no formal valuation.

It was later admitted on behalf of AVGL that no actual purchase agreement had been drawn up between Mr Alexander and Mr Hewitt. Mr Alexander had made a 'take it or leave it' offer. The question was raised, could HMRC be bound to a figure in a Self Assessment tax return? The answer here was no. Subject to the normal enquiry window and discovery assessment rules, the facts are that HMRC may challenge figures, and expect AVGL to provide sufficient evidence of any entry on a return. The valuation of the 2005 goodwill could therefore be challenged. There was no written partnership agreement in place between Mr Hewitt and Mr Alexander between 2000 and 2005, and evidence was contradictory. This is not unusual in a farm partnership situation.

Mr Hewitt initially said that the day to day running of the practice was all done by Mr Alexander, and that he had no role in practice administration or dealing with its suppliers. However, he conceded subsequently that this was not, in fact, the case. All this muddled information opened the door to the Partnership Act 1890 with a long reach. As will be seen when looking at the tribunal's final conclusions, if you don't want the Partnership Act 1890 to step in, it must be specifically ruled out in the agreement.

Partnership Act 1890

A big take away point of the case was the importance of the partnership agreement. It may be unwelcome news for clients who are partners to insist on formal valuations, but shortcuts can be expensive in the long run. Partnerships need partnership agreements. Without them, the Partnership Act 1890 applies and every twist and turn of contradictory evidence takes away control from the partners and how they want matters to apply.

The 1890 Partnership Act applies by default. If the owners don’t like the outcome, they should make sure they have an alternative legal agreement. Creative solutions may be possible, but they don’t happen by accident. The lesson to learn is obtain the evidence and retain it.

The one deduction that might have been obtained in this case, for the 2012 goodwill, was denied through lack of evidence. Remember that the regime in Scotland can be different. In this case, it was held that location did not change the outcome, but with devolution creating increasing divergence in tax rates (and rules for fully devolved taxes), it should at least be on the checklist.

The tribunal’s findings

The goodwill acquired on acquisition of the neighbouring practice (the 2012 goodwill) was potentially allowable under ‘case B’ (Corporation Tax Act 2009 s 882(4)). It was third party goodwill acquired by the company via an intermediary (the partnership); and the partnership had itself acquired the goodwill after 1 April 2002. However, the tribunal decided that there was insufficient evidence to show what deduction should be allowed, so no deduction was permitted.

In respect of the 2008 goodwill purportedly arising when Mr Walker joined the practice, it was held that Mr Walker, as an employee, contributed no goodwill. This was acknowledged by all parties during the hearing. No information had been provided to support the acquisition of goodwill from Mr Walker. So, there was the combination of no partnership agreement and lack of supporting evidence.

The goodwill acquired by Mr Hewitt when he took over the business from Mr Alexander (the 2005 goodwill), was not allowable, as Mr Hewitt was a partner in 2005 before Mr Alexander retired. The goodwill was deemed to exist before 1 April 2002.

Scottish partnership: the difference

Before reaching its conclusion, the tribunal addressed a couple of additional legal points. Firstly, it explored ownership of goodwill. Secondly, it considered whether the position is different for Scottish partnerships. HMRC’s position in this case was that

an existing partner could not ‘acquire’ goodwill from a retiring partner, on the grounds that partnership property is not owned by the partners individually. Rather, it is owned in partnership as partnership property. The logical consequence would be that you can’t sell what you don’t own.

There are lots of points to take away from this case and it is essential to read the detail of the case.

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