Analysis

Encountering intangibles: some practical suggestions

Speed read

HMRC's intangibles consultation may well produce improvements to CTA 2009 Part 8 in due course. In the meantime, difficulties can arise on pre-sale reorganisations and break-up transactions, although some of these can be solved through creative structuring. Particular care is needed when dealing with partnerships, as that aspect of the regime is no longer coherent.

Gregory Price
Macfarlanes
Gregory Price is a senior solicitor in the tax and structuring group at Macfarlanes LLP. He advises on the full range of corporate tax issues, with a particular focus on group tax planning and corporate tax advice for substantial privately owned businesses. Email: gregory.price@macfarlanes.com; tel: 020 7849 2754.

As HMRC's consultation on the intangibles code comes to an end (on 11 May 2018), this article highlights some of the issues that might be encountered under the current rules by those implementing transactions in advance of any future improvements to the regime. I focus on three tricky areas: pre-sale reorganisations; break-up structures; and companies operating through partnerships.

Pre-sale reorganisations

The problem with intangibles on a pre-sale reorganisation is the degrouping charge; more specifically, the inability to shelter a CTA 2009 s 780 charge using the substantial shareholding exemption (SSE). This conflicts with the position for chargeable gains assets (which of course includes pre-2002 intangibles and, in particular, goodwill in many businesses). Since 2011, it has been possible to eliminate CGT degrouping charges on a pre-sale reorganisation if the sale itself qualifies for the SSE, as a result of amendments to TCGA 1992 s 179 and Sch 7AC. The effect of these amendments is to treat the degrouping charge as part of the third-party sale consideration (to allow for SSE shelter) and to relax the SSE 12-month minimum holding period where trading assets are transferred around a group.

In terms of changes that HMRC could make as a result of the consultation, discussions with corporate groups reveal that the highest priority is to address this imbalance in relation to the intangibles degrouping charge.

For the time being, experience suggests that the practical solutions are as follows:

- First, consider whether the company which holds the highest value intangibles can be the target company for the sale (to reduce the need for pre-sale intra-group transfers of IP). This may bring its own problems, such as a large scale hive-out of retained assets, or the need to move employees in or out under TUPE. If real estate needs to be moved to the IP company, this might trigger other degrouping charges (clawing back SDLT relief).
- Second, elect to reallocate any IP degrouping charges to a retained group company that has current year losses or carried forward non-trading losses. The reallocation gives rise to a non-trading credit in the company accepting the charge (s 792).
- Third, reallocate the gain to a retained group company which is investing in new IP and claim rollover relief (s 794).
- Finally, get on top of valuation issues as early as possible. Establish the market value of any IP which is transferring intra-group to inform discussions about deal structuring and the impact on price.

Break-up structures

A number of common break-up structures (such as a demerger by reduction of capital or by liquidation) are not tax neutral if they involve the transfer of valuable intangibles. This is because the break-up steps typically involve an intra-group transfer of assets, followed by the transferee leaving the group. The combination of the SSE, dividend exemption and reconstruction rules eliminate or defer almost all of the relevant tax charges on a demerger – apart from the s 780 degrouping charge.

There is a technical solution to this, but it is not appropriate in all circumstances: tailor the break-up transaction to ensure it meets all of the conditions for a statutory demerger (under CTA 2010 ss 1076–1078) and then rely on CTA 2009 s 787. Of course, this assumes that the circumstances are such that these conditions can be met in the first place.

In other situations, the answer may be to avoid transferring intangibles intra-group ahead of a demerger. This means either leaving the intangibles where they are or trying to achieve a tax neutral transfer (e.g. under s 818) to someone outside the group.

If HMRC responds positively to the messages received during the consultation, there must be a good chance that break-up transactions can be simplified in the future, as a result of improvements to the intangibles degrouping charge.

Partnerships

CTA 2009 Part 8 has little to say about partnerships and where amendments have been introduced (in FA 2016) these have been justified by HMRC on anti-avoidance grounds. From a practical perspective, it is worth noting that there are a range of commercial reasons why a company might be a member of a partnership which holds intangible assets; and that the difficulties thrown up by the legislation are not confined to the types of situations (such as market value step up schemes) that have attracted HMRC's focus.

To give two common examples: for joint ventures between companies, a limited liability partnership might be an ideal vehicle for pursuing a common commercial objective, sharing profits and losses 50:50. And for corporate groups in the professional services sector, partnerships (which are the traditional vehicle for advisory businesses) continue to be used even where the majority stake is held by a company rather than individual fee earners.

From a tax perspective, the choice to use a partnership gives rise to unexpected difficulties for some corporate partners. This is a product both of what Part 8 (as amended in 2016) says expressly in relation to partnerships, and also of the gaps left by the lack of a code for partnerships within Part 8.

The figure (above right) suggests a practical framework for dealing with the current rules. In these examples, I have used an LLP. The analysis should generally be the same for an unincorporated partnership, unless the partnership's lack of legal personality means that the accounting treatment applied by the corporate partner is different (see below).

1. Transactions between the LLP and third parties

For transactions between the LLP and third parties, profits are computed as if the LLP were a company. Corporation tax resulting from notional Part 8 credits and debits is payable by A Ltd (to the extent of its interest in the partnership). There is no provision to this effect in Part 8, but this form of 'look through' is consistent with the general corporation tax rules applicable to partnerships (CTA 2009 ss 1258 and 1273). This is the approach that the tribunal adopted in relation to Delaware LPs in the recent case of *Bloomberg Inc and another v HMRC* [2018] UKFTT 205 (TC).

This is broadly consistent with the position under the chargeable gains rules for transactions between an LLP holding chargeable gains assets and third parties (TCGA 1992 ss 59–59A, as supplemented by HMRC's Statement of Practice D12). It also achieves something similar to the loan relationships rules, albeit that those rules have a specific code (at CTA 2009 Part 5 Chapter 9) for computing profits and losses of corporate partnerships.

2. Transfer of intangibles between A Ltd and LLP

This is where the logic starts to break down. Section 845 (as amended in 2016) requires the transfer of an intangible between the LLP and its corporate partner, A Ltd, to be treated for tax purposes as a transfer at market value.

For chargeable gains assets, transfers between a partner and a partnership are a tax 'nothing' (to the extent of the partners' fractional share in the underlying asset) – a longstanding practice recorded in SP D12. Before FA 2016, it was generally understood that the same was true for intangible assets, either by analogy with SP D12 or because this was the effect of CTA 2009 ss 1258 and 1273.

Similarly, for loan relationships, the transfer of an asset between a partnership and its corporate partner is not generally regarded as a taxable event in itself.

The amendments to CTA 2009 s 845 have therefore introduced an anomaly. On setting up, collapsing or otherwise reorganising a partnership, transfers of chargeable gains assets and loan relationships are broadly tax neutral, whereas transfers of intangibles are taxed at market value.

This can cause real difficulties on commercial transactions. It means, to use my joint venture example, that on buying out its 50:50 joint venture partner, the group acquiring complete control of the LLP cannot wind up that vehicle or move any underlying intangible assets around its group without incurring a market value tax charge. Similar issues arise on M&A transactions where the target business includes any divisions organised as LLPs – the purchasing group will not have a free hand to reorganise the target after the acquisition.

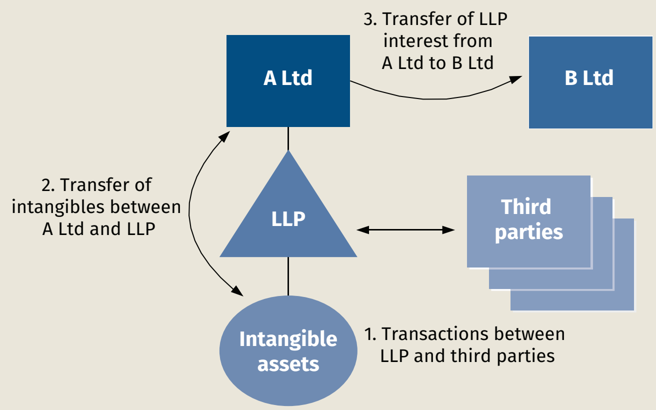
In these circumstances, a partnership turns out to offer the worst of both worlds: transfers in or out are not disregarded; and the partnership cannot benefit from the tax neutral transfer provisions (s 775) that apply to companies within the group. HMRC has indicated in correspondence that this is the legislative effect, notwithstanding the anomalous result.

Let's hope the consultation provides an opportunity to resolve this. The simplest fix would be to restrict the 2016 amendments to those avoidance situations at which the measure was purportedly directed when it was introduced. Without that change, corporate groups may be best advised that, despite the commercial suitability of such vehicles, they should avoid using partnerships or LLPs at all – a case of the tax tail wagging the commercial dog.

3. Transfer of LLP interest from A Ltd to B Ltd

The final piece of the jigsaw is a transfer involving A Ltd's share in the LLP. This is an area where the taxation of unincorporated partnerships and LLPs may differ, notwithstanding that CTA 2009 s 1273 generally ensures that LLPs are treated in the same way as partnerships in the corporation tax code.

Figure: A practical framework for dealing with the current rules



The reason for that difference is the primacy of the accounting treatment, as adopted by CTA 2009 Part 8. If a company sells a share in a partnership which is shown in its accounts as an investment (i.e. interest in a subsidiary), the disposal of that interest is outside the scope of Part 8 (by virtue of s 807). The accounting evidence available in *Armajaro Holdings Ltd v HMRC* [2013] UKFTT 571 suggests that this will generally take transactions involving LLP interests outside the regime (as these are accounted for as an interest in a subsidiary). However, the position for unincorporated partnerships might be different, as a corporate partner might show the underlying assets on its own balance sheet (in which case the s 807 exclusion does not apply). If a company does account for the sale of a partnership share as a (partial) realisation of underlying intangibles, it will be taxed on the relevant credits and debits under Part 8.

To compare that with the other regimes, for the purposes of chargeable gains, disposals of partnership shares are generally assessed by reference to the change in fractional ownership of the underlying assets, rather than treating the partnership share itself as a chargeable gains asset (under SP D12). For loan relationships, there is no express provision. In informal consultation in the past few years, HMRC has indicated a preference for introducing a rule that treats a disposal of a partnership interest as a fractional disposal of any underlying loan relationships (as a 'related transaction'). For the time being, however, CTA 2009 Part 5 does not provide an answer.

In summary, on the transfer of LLP interests, if the underlying assets are intangibles, the transfer of the LLP interest is likely to be treated as a disposal of a chargeable gains asset in much the same way as a share in a limited company, albeit without the potential benefit of the substantial shareholding exemption. HMRC's submissions in the recent *Bloomberg* case (paras 153–155) offer support for this view.

Improvements to follow?

In each of these areas, significant distortions could be removed by tightening up anti-avoidance rules to avoid collateral damage and by aligning the treatment of intangibles with chargeable gains assets on a degrouping. With the consultation coming to an end, HMRC has an opportunity to make those improvements. It should take it. ■

For related reading visit www.taxjournal.com

▶ Consultation on intangibles: finally... (Ashley Greenbank, 7.3.18)