Analysis

LLPs and intangibles: avoiding traps in M&A and intra-group transfers

Speed read

Intra-group transfers of intangible fixed assets (IFAs) to or from LLPs are increasingly common as precursors to M&A transactions or post-acquisition tidy-ups. Unfortunately, the tax treatment of such transfers seems confused and makes tax neutral reorganisations involving IFAs materially harder to achieve than those involving chargeable gains assets. One reason is that while the recent case of *Muller* tells us to apply market value deeming provisions to LLPs as if they are companies, CTA 2009 prevents LLPs from being part of tax neutral groups precisely because they are not. Elements of the reasoning in *Conran* provide a possible workaround.

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M&A activity involving LLPs

Limited liability partnerships (LLPs) have been available to use in UK business structures for more than 20 years, and as LLPs have become more familiar as a vehicle we have seen increased M&A activity involving the acquisition of LLPs or of corporate groups that contain LLPs.

Often the value of the business in question is driven by its intangible assets, for instance, professional services firms and their customer lists. On the acquisition of an LLP, a purchaser may require the sellers to contribute to the LLP any relevant intangibles which are held elsewhere in the seller group but form part of the transaction perimeter. Purchasers may also wish to amalgamate the intangible assets of recently purchased LLPs within their core business. M&A transactions involving LLPs are therefore commonly bookended by internal reorganisations of intangible assets within a corporate group.

The transfer of intangibles in these circumstances is typically subject to the rules (in the case of corporate partners) for intangible fixed assets (IFAs) in CTA 2009 Part 8.

In very broad terms, there are two relevant policy objectives that underlie the tax rules for transfers of intangibles between connected parties. First, the transfer of an IFA between parties that are in common corporate ownership should be tax neutral. Second, it should not be possible to 'step up' the tax value of an IFA (without a tax charge for the transferor) by transferring it to a connected party.

In the authors' view, concern on HMRC's part about the second objective (preventing 'step ups') has caused unintended mischief in relation to the first objective (tax neutral transfers). As a result (in particular, the 2016 change of law described below) it is materially more difficult to achieve an efficient LLP/group reorganisation involving IFAs than is the case for chargeable gains assets or loan relationships – even though in principle the outcome should be the same.

Transfers between an LLP and its members

Unlike for chargeable gains purposes, where a transfer of assets between a partner and a partnership is generally accepted to be a tax 'nothing' (as explained in HMRC's Statement of Price D12), a transfer of intangibles to or from an LLP and its corporate members will generally be taxable as a market value transaction. This is because:

- the related party transfer rule in CTA 2009 s 845 was amended in 2016 to include transfers involving partnerships; and
- the provision that allows for tax neutral transfers within groups (CTA 2009 s 775, which is the equivalent of the familiar TCGA 1992 s 171 provision) appears not to override the market value rule if the transaction is a transfer between an LLP and its corporate members, because only companies can be members of such groups, and LLPs are not companies for these purposes (CTA 2009 ss 764 and 765).

From a policy perspective, this produces the wrong answer: in combination, these propositions are not working as intended.

This causes real commercial difficulties. On acquiring an LLP, the purchaser group does not have a free hand to wind up that vehicle or reorganise how underlying intangibles are held without incurring a market value tax charge.

In the rest of this article, we review some recent decisions on the IFA rules and test whether the problem described above is a real one (yes) and whether there are any potential workarounds (possibly).

Recent cases: *Muller*

The recent decision in *Muller UK & Ireland Group LLP and others v HMRC* [2023] UKFTT 221 (TC) involved the transfer of various intangible assets from the corporate members of an LLP to that LLP. The central question was whether this transfer had taken place between 'related parties' for the purposes of CTA 2009 s 882. If so, then (i) the assets would not have been brought within the IFA regime, and (ii) tax relief in respect of the amortisation that the LLP had included in its accounts would be denied.

The focus of *Muller* was whether LLPs could be 'companies' for the purposes of the IFA regime, and the role of CTA 2009 s 1259 (which sets out how to calculate partnership profits for corporation tax purposes) in answering that question.

One reading of the definition of 'related parties' in CTA 2009 s 835 is that an LLP could only meet the definition of 'related party' in respect of its members if the LLP were itself a company. This is because definition sets out the conditions under which 'a person (A)' is related to 'a company (B)', and then – for the tests relevant to an LLP and its members – goes on to assume that person A is also a company. Counsel for the taxpayer in *Muller* argued that s 1259 was not a 'deeming provision' that required one to actually imagine the relevant LLP was a company, or to hypothesise a separate fictional company with the ownership characteristics of the LLP.

The FTT disagreed and held that the related party

provisions could apply to an LLP, essentially as a logical implication flowing from s 1259 and calculating the taxable profits of an LLP as if the LLP were a company.

That was enough to decide the appeal, but the FTT went on to confirm that certain 2016 legislative changes had put the matter beyond doubt.

Muller and developments in the IFA regime

FA 2016 inserted various new provisions to the IFA regime which both (i) extended the conditions under which parties could be 'related' to those in which the 'participation condition' in TIOPA 2010 s 148 was met, and (ii) stated that, for those purposes, references to 'companies' in the legislation could be read as references to partnerships.

We talked at the start of this article about two policy objectives in the IFA regime, with HMRC focused on the second (avoiding 'step-ups'). *Muller* is not a case about tax neutral transfers, but it does seem to us to support some of the concerns with the IFA regime expressed above, i.e. that in restricting step up transactions, the legislation has become difficult to use when looking to achieve tax neutral transfers involving LLPs.

The rationale for the 2016 changes was to tackle arrangements that looked to create opportunities for tax-deductible amortisation by transferring assets (for example contributing internally generated intangibles, or pre-IFA regime goodwill, to an LLP) with no change in ultimate economic ownership and/or no tax charge on the transfer. HMRC stated that this type of planning was ineffective under the IFA rules and, by adding LLPs to the related party rules in 2016, set out to put this beyond doubt.

> The *Conran* line of reasoning prompts the question: what if the LLP members and the transferee in that case had all been companies that were part of the same UK group?

Whilst *Muller* was not argued as a case about tax avoidance, it is possible to see it as the type of fact pattern where the 2016 changes could have been intended to affect the outcome.

However, another effect of the 2016 changes was to make it more likely that intra-group transfers involving LLPs could be caught by the deeming rules at CTA 2009 s 845, which treat transactions between related parties as taking place at market value (i.e. a rule which creates tax charges, rather than eliminating step ups).

Although *Muller* did not directly address the question of whether its conclusions on related parties should carry over to the s 845 market value rules, it is hard to see how the conclusion could be otherwise given both sections rely on the same definition of related parties at CTA 2009 s 835, and contain the same additional wording following the 2016 changes. While the authors are aware of arguments to the effect that the participation condition may not be met in relation to certain LLP structures where the related party tax charge issue arises, the FTT's reasoning in *Muller* would suggest this is a difficult line of argument in most cases.

As noted above, our concern that intra-group transfers involving LLPs are being taxed *unintentionally* is not (at first sight) addressed by the tax neutral transfer rules, because whilst these rules (CTA 2009 s 775) have priority over s 845, they apply only to transfers between companies and LLPs are not 'companies' as defined for this purpose (CTA 2009 s 764). While it is true that *Muller* tells us to treat LLPs as companies for certain purposes, the fact that this exclusion has a statutory footing must impose a hard limit to that reasoning.

Conran: transfers involving LLPs and other related parties

It is interesting to compare issues reviewed in *Muller* with those in *Conran v HMRC* [2022] UKFTT 39 (TC). Broadly, *Conran* is a case that applies the related party analysis between an LLP's members and the other party to a transaction – not by reference to the LLP itself. The key difference in the fact pattern is that the assets in *Conran* were transferred between the LLP and a related party other than the LLP's own members.

Conran concerned the various tax effects of the (pre-2016) transfer of an LLP's business to a company for cash consideration. An individual (Mr Conran) was both the controlling member of the LLP and the indirect 100% owner of the transferee company. The question in that case was whether the parties were related and the predecessor to the s 845 market value deeming rules applied.

Rather than focusing on arguments around whether LLPs could be related parties, in *Conran* the issue was framed as how to identify the persons treated as the transferor and transferee for tax purposes (and then see if those persons are related).

In answering this question, the FTT found the tax transparent nature of LLPs decisive: the question was whether the members of the transferor LLP (not the LLP itself) were related to the transferee.

LLPs and intra-group transfers

Given our focus in this article on group reorganisations, the *Conran* line of reasoning prompts the question: what if the LLP members and the transferee in that case had all been companies that were part of the same UK group? Extrapolating from *Conran*, that transfer ought to be tax neutral under CTA 2009 s 775, because it is treated as a transfer between *companies* in the same group. That should be the case even if it is *also* treated as a market value transfer made by an LLP to a connected party under s 845, because s 775 expressly has priority over s 845 in cases where both provisions apply.

This would achieve a logical mirroring of how the capital gains regime works in the same circumstances; as a result of TCGA 1992 s 59A, the LLP itself is disregarded and tax neutrality is available where the required group relationship obtains between its members and the other party.

That suggests a potential workaround in situations where a group has acquired an LLP that holds valuable intangibles and plans to carry out integration via a group reorganisation thereafter.

Can this be reconciled with the points raised in *Muller*? On one level, it makes no sense to treat transfers between an LLP and its corporate members as taxable at market value when transfers between an LLP and a sister company could be tax neutral. But given the (we think, unintended) difficulty that the 2016 changes introduced when dealing with connected party LLP transfers, it would be reasonable to explore this type of workaround to avoid what is otherwise a 'bear trap'. The alternative – which would be our preference if HMT and HMRC can be persuaded to revisit these issues – is for a legislative solution to repair some of the unintended damage done in 2016 (provisions that the FTT in *Muller* described as 'not happily worded'). ■

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- Cases: *Muller UK & Ireland Group LLP and others v HMRC* (14.3.23)
- Cases: *J Conran and another v HMRC* (15.2.22)