Ask an expert

Transfer of trading operation

Q Our client has wholly owned a small trading company for many years, but is encountering difficulty in selling the business. The latest proposal is to sell the trading operation to two senior employees. The land and buildings, which are valued at £1m, will be retained by the company and leased to a new company, initially owned by the client, into which the trading operations will be transferred. The trading assets are valued at £350k and goodwill at £150k, and it is proposed that the shares in the new company will be sold by the client to the senior employees. Advice regarding any tax pitfalls arising from these transactions would be appreciated. Obviously, the client would like to claim entrepreneur's relief if at all possible, but the success of the proposed deal is not dependent on this. It is recognised that at least some tax will be payable on the sale of goodwill.

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A There are several ways to approach this: which is the most tax-efficient (and what complexity of planning is warranted) will depend to some extent on the base costs of the assets and indeed of the shares in the company.

It is assumed that the basic proposal is that the trade and goodwill will be sold to the new company at their market value. Presumably this will initially be left outstanding on loan account with the result that the market value of shares in the new company (and the proceeds of any subsequent sale of the shares to the senior employees) will be negligible. The value represented by the sale of the business will remain effectively locked up in the existing company and could be extracted only by dividend or remuneration (not very tax-efficient) or on liquidation (which would also involve crystallising any tax charge on the disposal of the land and buildings). Entrepreneurs' relief would however be likely to be available in respect of the capital gain arising to the owner on the liquidation.

Another option would be to approach the problem from the opposite direction – sell the land and buildings to a new company (for their market value) and then sell the shares in the existing company. This would avoid any gain on disposal of goodwill and would put money directly into the client's hands: but there would be an SDLT cost in transferring the land and buildings and their disposal may give rise to a chargeable gain within the company.

Splitting the land and buildings from the trade by an exempt distribution (CTA 2010 s 1075) is ruled out for a variety of reasons including the fact that post-demerger the company will not be carrying on a trade (and that a change of control is contemplated). In principle, it may be possible to undertake a 'liquidation demerger' using the Insolvency Act 1986 s 110: a liquidator would sell the trade to Newco 1 and the land and buildings to Newco 2, in each case in consideration of an issue of shares to the client. TCGA 1992 s 136 would operate to avoid any tax charge on the client's receipt of shares and s 139 on the company's disposal of its chargeable assets. However, the fly in the ointment is that this requires a 'reconstruction' involving the transfer of a business: while the sale of the trade should qualify it is doubtful if the mere transfer of the land and buildings would do so. And, in the writer's experience, the costs of appointing a liquidator can rapidly eat up most of the tax savings to be made by a liquidation demerger.

Yet another possibility, if the idea is that the business will pass to the senior employees in the near future, is a straightforward management buy-out structured in the traditional way: the employees would form Newco which would buy the entire shareholding, leaving part of the proceeds outstanding on loan account. Post-sale, the property might be sold to the client (at market value) and the proceeds paid up to Newco as dividend and used to pay off the purchase price. Previously, such a sale of shares and partial repurchase of underlying assets may have been considered to fall foul of the 'transactions in securities' legislation at ITA 2007 Part 13 (see HMRC's *Company Taxation Manual* at CTM36875) though the 'fundamental change of ownership' exemption at s 686 will now on the face of it save the day.

If none of the above quite hit the mark, more sophisticated planning may need to be considered. One such strategy might be to alter the articles of association of the company such that the shares in issue are divided into two classes: A shares, which broadly speaking carry all rights attaching to the trading activities of the company; and B shares, which carry all rights relating to the land and buildings owned by the company. This may amount to a 'reorganisation' of share capital but no matter: TCGA 1992 s 127 ensures that within a single company, such a reorganisation has no CGT consequences. One might then sell the A shares (at their market value) to a Newco promoted by the senior employees. Any gain on the disposal should be capable of qualifying for entrepreneurs' relief. The trade and assets might then be transferred to Newco as a distribution in specie, following which the A shares would have become economically worthless and could be cancelled, leaving the client with full ownership of the company and, through it, ownership of the retained land and buildings. The disposal of goodwill to Newco would be treated as made at market value, so there is no tax saving there: but the arrangement would result in the client receiving cash in respect of which a tax charge at only 10% would be in prospect.

A number of possibilities then, but two caveats: first, don't overlook the possibility that the simplicity of a sale of assets may outweigh its relative tax-inefficiency; and, second, the more complex the planning becomes, the more important it is to have regard to the possible scope of anti-avoidance legislation and in particular to consider seeking a clearance under Part 13.

And we have not even begun to consider the employment-related securities implications of a purchase by the senior employees! ■

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