Down and out?

Hannah Hurley discusses the corporation tax treatment of common group transactions when companies run into difficulties.

Amid falling profits and asset values, many companies will find themselves where they do not want to be – whether with a lack of reserves, in administration or in liquidation. Putting aside the limited scope for tax planning in these scenarios, some issues are worth considering, particularly the tax consequences of even the simplest group transactions. These include the transfer of assets around a group, the waiver of debt and the use of tax losses.

To illustrate these issues, we will consider the position of the ***Piste Group***.

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Piste Holdings Limited is the parent of the following companies:

- Green Limited owns the business property and has no distributable reserves;
- Blue Limited operates a winter sports business and is in administration; and
- Red Limited is developing an online app and also has a trading subsidiary, Black Limited, which is in liquidation.

We can look at these companies in a little more detail.

Green Limited

Green Limited has no distributable reserves. Although there are no specific taxation implications of having negative reserves, the company law implications of any group transaction involving Green Limited would need to be reviewed closely. Primarily, this arises from the broad meaning of a 'distribution' for the purposes of the Companies Act 2006, which goes much further than simply cash dividends. Broadly, it is any distribution of a company's assets to its members, aside from:

- an issue of fully or partly-paid bonus shares;
- a share capital reduction by repaying paid-up share capital or by reducing the liability of any members on share capital not paid up;
- the purchase of the company's own shares out of capital or unrealised profits; or
- a distribution to members on the company's winding up.

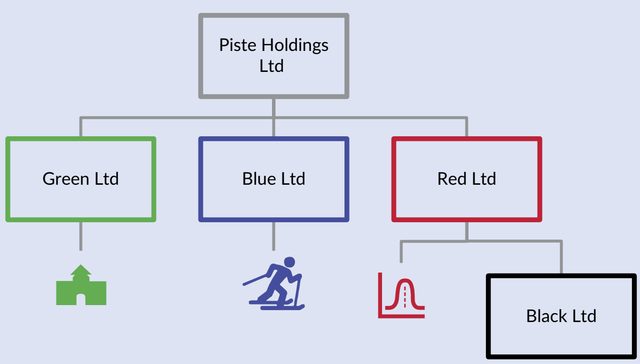
As such, the transactions that might be included as a distribution (depending on the circumstances of the transfer) include but are not limited to:

- the transfer of assets at an undervalue (as established as a possibility in the case of *Aveling Barford Ltd v Perion Ltd* (1989) 5 BCC 677);
- the forgiveness or assumption of debt for no consideration;
- interest-free loans (except for those that are repayable on demand); and
- the surrender of tax losses without consideration.

Key points

- Companies in administration or liquidation may face restrictions on group transactions.
- Does a company have distributable reserves?
- Connected companies and loan waivers.
- Administration will break the connection and may result in the loss of group relief.
- Liquidation will end a company's existence.
- Entitlement to the substantial shareholding exemption.

Piste Group



In the recent case of *SSF Realisations Limited v Loch Fyne Oysters Ltd and Others* (2020) EWHC 3521 (Ch) (*Loch Fyne*), the judge decided as a matter of law, that the assumption of an obligation to pay for services rendered in the past (where no obligation had previously existed), would be characterised as a voluntary distribution.

Returning to the example of Green Limited, let's say that the company owns the freehold of the property, which was valued at £500,000 at the last accounting year end. It is intended that Green Limited should transfer the property to Piste Holdings Limited (its immediate parent company) at its book value of £350,000.

Implications

The taxation of this transaction follows a well-trodden path. For chargeable gains purposes, the transaction would take place under TCGA 1992, s 171. Green Limited would be deemed to dispose of the property at a price that gives rise to neither a gain nor loss, and Piste Holdings Limited would inherit the base cost (plus any indexation) of the property from Green Limited. The transfer at undervalue to Piste Holdings Limited would be a distribution for tax purposes under CTA 2010, s 1000(1), but CTA 2010, s 931B exempts the distribution from tax (assuming Piste Holdings Ltd is a small company). Stamp duty land tax should not arise under the group relief provisions in FA 2003, Sch 7 Pt 1.

However, without distributable reserves, the question of whether any given transfer of an asset at undervalue will necessarily constitute an (unlawful) distribution is not simple. The cases subsequent to *Aveling Barford* would also need to be considered, including in particular *Progress Property Co Ltd v Moore and anor* [2010] UKSC 55. It is clearly preferable to avoid the question entirely, rather than engaging the harsh consequences of an unlawful distribution or the costs and uncertainty of ascertaining the correct characterisation in the particular case. These consequences can be seen in *Loch Fyne*, where the shareholding company was liable to repay the unlawful element of the distribution and two of the directors of the distributing company were held personally liable to compensate the distributing company for the same sum.

It might be possible to increase the levels of distributable reserves by way of a share capital reduction. For a private company, this should not be overly onerous. Broadly, it would require a special resolution made alongside a solvency statement by the directors. However, again, a solvency statement is not a matter to be treated lightly, including because of the potential criminal sanction attached thereto.

In practice, it may not be obvious that a company does not have distributable reserves, particularly if several transactions are occurring in quick succession. Here, it is useful to model the balance sheet of each involved company to ensure no company is left without distributable reserves.

Blue Limited

Blue Limited operates a winter sports shop in London. With the closure of the shop throughout much of 2020, and having exhausted routes of financing, it became clear to the directors that the company would be unable to meet its debts in the next quarter. The directors therefore appointed an administrator, hoping that the company could ultimately be rescued.

The objective of the administrator is set out in the Insolvency Act 1986, Sch B1 para 3. Briefly, and without seeking to set out the nuances of para 3, the administrator's aim is to rescue the company as a going concern, to achieve a better outcome for the company's creditors than if it were simply wound up, and (if all else fails) to sell the property of the company to satisfy the creditors (whether preferential or secured).

Let us say that Blue Limited owed £100,000 to Piste Holdings Limited, which was willing to waive this amount to assist its subsidiary.

The tax treatment for the waiver of this loan depends on whether Blue Limited and Piste Holdings Limited are still connected companies. Looking at the definition in CTA 2009, s 466, the two companies continue to be connected for the accounting period as long as one of them controls the other or both are under common control at any time in that accounting period. Control means that a person can direct the affairs of the company in accordance with their wishes, by virtue of either holding shares, voting power or any other document. Who has control will be a question of fact and should be examined with care in each case.

Once Blue Limited is in administration, a new accounting period will commence and (in this case) Piste Holdings Limited will no longer have control of Blue Limited. For Blue Limited's purposes the companies will, therefore, not be connected for the purposes of the loan relationship rules. However, CTA 2009, s 322 provides that Blue Limited would not need to bring in a taxable credit from the release of the debt, assuming the company is insolvent on entering administration and that the loan is released after the administrator is appointed.

For Piste Holdings Limited, there is no trigger for the end of the accounting period. Therefore, for loan relationships it will be connected to Blue Limited until Piste Holdings Limited's ordinary year end.

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Blue Limited continues to trade after the appointment of the administrator and makes further trade losses during this time. Group relief is unlikely to be available here because HMRC's view is that the appointment of an administrator results in a parent company (Piste Holdings Limited) losing control of its subsidiary (Blue Limited). See, in relation to the distinct situation of receivers, the Court of Appeal's decision in *Farnborough Airport Properties Company and anor v CRC* [2019] STC 517.

If Blue Limited had a subsidiary, it is arguable that group relief is theoretically still available between Blue Limited and the subsidiary because the provisions at CTA 2010, s 154(3) would not apply (because there would be no difference in the control of Blue Limited and that subsidiary). However, it should be noted that HMRC could argue that CTA 2010, s 1124 control is not shared here because the parent company (here Blue Limited) does not have control of itself.

Key provisions

Key provisions for companies in administration or liquidation

Intra-group transaction	*Administration*	*Liquidation*
Group relief	CTA 2010, s 154 denies group relief if another 'person' could obtain control of the claimant company but not the surrendering company (or vice versa).	
Waiver of debt (insolvent creditor)	If a lender is insolvent, the company can claim a deduction for impairment or the waiver of debt owed by a connected company (CTA 2009, s 357). The debtor will not be taxable on the credit on the release of the debt (CTA 2009, s 359).	
Waiver of debt (insolvent debtor)	'Control' for the purposes of the connected company rules is broken by entering into administration or liquidation. The definition of connected companies is at CTA 2009, s 466 and refers under CTA 2009, s 472 to the ability to secure that the relevant companies' affairs are conducted in accordance with their wishes. Note that if a company is connected to another at any point in its accounting period, then the loan relationship will follow the connected company rules for the whole accounting period.	
Transfer of chargeable assets under TCGA 1992	Beneficial ownership remains and therefore no breaking of a chargeable gains group.	TCGA 1992, s 170(11): passing a winding-up resolution does not cause a company to leave a gains group.
Transfer of intangible fixed assets under IFA regime	Beneficial entitlement remains and therefore no breaking of the intangible fixed assets (IFA) group.	CTA 2009, s 769: passing a winding-up resolution does not cause a company to leave an IFA group.
De-grouping provisions	The de-grouping provisions should not be in play unless the company is wound up or sold out of the group.	There is a risk that the de-grouping provision at TCGA 1992, s 179 will apply if a company is wound up within six years of receiving an asset on a no gain, no loss basis.

Although they have control of Blue Limited's assets, the administrator does not take beneficial ownership. For this reason, the capital gains group would not be broken and the no gain, no loss rule under TCGA 1992, s 171 would still apply for any transfers of chargeable assets within the group. Intra-group transfers of intangible assets will follow these rules because the definition of a subsidiary relies on the beneficial entitlement of profits available for distribution and assets on a winding up.

"The liquidator's aim is to sell the company's assets, pay the company's debts and return any remaining capital to the shareholders."

Red Limited

Red Limited was a new venture by Piste Holdings Limited, which was developing an app to track athletes' performance. It was financed by bank debt, but revenues were not as healthy as expected and the company was unable to service its interest payments. Ultimately, a liquidator was appointed to dissolve the company. Red Limited has one relatively successful trading subsidiary (Black Limited).

Unlike administration, liquidation will end the company's existence and the liquidator's aim is to sell the company's assets, pay the company's debts and return any remaining capital to the shareholders.

The liquidator becomes the beneficial owner of the company's assets. However, due to a series of provisions in the tax code, in many cases the ultimate tax effect of group transactions is similar to a company in insolvent administration.

For example, at TCGA 1992, s 170(11), express provision is made such that a company in liquidation will not leave a capital gain group. So if Red Limited were to transfer a chargeable asset to another company in the group, it would do so on a no gain, no loss basis. It is worth bearing in mind that, once it is under the control of the liquidator, it is unlikely that assets could be transferred from Red Limited at an undervalue, unless as a return of capital to Piste Holdings Limited. Similar rules exist for the intangible fixed assets (IFA) regime at CTA 2009, s 769 ('Continuity of identity of group').

The treatment of a loan waiver from Piste Holdings Limited would follow the provisions set out above – the same legislation applies whether a company is in insolvent liquidation or insolvent administration.

Piste Holdings Limited would lose control of Red Limited on the appointment of a liquidator, so the latter could not surrender any tax losses made in liquidation to the former company. Equally, control of Black Limited would be vested in the liquidator, and as such tax losses could not be surrendered here either. Red Limited (and Black Limited) would not be able to claim group relief from other members of the Piste group, which may be problematic if Red Limited generates chargeable gains from the sale of assets during liquidation.

For completeness, if Red Limited were able to sell its subsidiary to a third party, the substantial shareholding exemption (SSE) should still apply – as long as the usual conditions were met. Although the SSE usually requires the seller to have beneficial ownership of the shares in the target subsidiary, TCGA 1992, Sch 7AC Pt 2 para 16 disregards the effect of the liquidation for these purposes.

If any assets had been transferred to Red Limited on a no gain, no loss basis within the past six years, the de-grouping rules at TCGA 1992, s 179 would theoretically apply and as such a gain should be calculated on the market value of the asset at the date of transfer. Note that similar clawback provisions in the stamp duty land tax code might also apply.

Conclusion

The options available to a company in financial difficulty differ both as a matter of tax and general law depending on the particular situation in which the company stands at the time. There is no single cookie-cutter solution that can be used in every case. Careful attention should be paid to the distinctions and differences above, particularly with respect to the following points and the matters summarised in the ***Key provisions*** chart.

First, the timing of entrance into liquidation or administration should be planned carefully where possible to maximise the use of tax losses. Second, restructuring before a company enters liquidation may be necessary if it has received an asset on a nil gain, nil loss basis in the past six years. Third, group relationships should be reviewed in detail before asset transfers or loan waivers occur. Finally, issues should be considered in the round: company or insolvency law might prevent group transactions even if they have a neutral tax effect.

Planning point

When considering administration or liquidation of a company, consider the potential availability of tax reliefs before going ahead so that these are not lost unexpectedly.

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