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## Company reorganisations analysis - Tax-efficient joint ventures and mergers

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***Speed Read: Two ways for corporate activities to be amalgamated are the formation of joint ventures and the mergers of companies. The mechanics of setting up joint ventures can expose one or both parties to potential tax charges on degrouping of assets. TCGA 1992 s 181 provides relief from these charges for genuine commercial joint ventures. Companies can also be merged directly under UK company law, and cross-border mergers are permitted under EU legislation. New UK rules on chargeable gains were enacted to deal with cross-border mergers.***

While we say we work on 'mergers and acquisitions', the majority of our time is often spent on disposals and demergers, sometimes on acquisitions, but rarely on mergers. This article will look briefly at two forms of merger and their tax consequences.

### Mergers: forming a joint venture

In a joint venture two groups may each put part of their businesses into a joint venture company. A common mechanism to form a joint venture is:

- Each of the groups sets up a new subsidiary and hives down the appropriate assets (usually in return for an issue of shares, to generate base cost).
- One of the groups will set up the joint venture company.
- The new subsidiaries are hived down under the joint venture company by way of a share-for-share exchange.

There are other mechanisms but the tax consequences are often similar. We now have a jointly held joint venture group but, from a tax perspective, the new subsidiaries have left their respective groups holding assets that have been transferred to them within the last six years. So there is a *prima facie* degrouping charge under TCGA 1992 s 179, or for intangible assets, under CTA 2009 s 780. This would seem to be a barrier to the formation of joint ventures this way, but for the existence of TCGA 1992 s 181 (and its counterpart, CTA 2009 s 789 -- for convenience, I shall only refer to the TCGA 1992 provisions, as the intangibles provisions operate identically). Section 181 is specifically designed to facilitate the formation of

commercial joint ventures, by lifting the degrouping burden from these transactions.

There are several conditions to be satisfied for s 181 to apply. First, the merger must be for *bona fide* reasons and not for the avoidance of tax (any tax, this is not restricted to degrouping charges). And the merger cannot be 'with a view to disposal' of the business transferred. However, HMRC takes a sensible approach to the fact that most corporate joint ventures have an exit strategy.

The activities concerned must amount to a business, which means that the relief is not restricted to trading companies. This is not generally an onerous burden. The important point here is that both parties must put business into the joint venture, as s 181 will not apply if one company is putting in part of its business and the other is merely investing cash: this will not amount to a merger of businesses.

The legislation refers to a group acquiring an interest in all or part of another group's business, in return for giving up all or part of an interest in a business to the other group. For example, if we look at the transactions described above, the result is that each company has given up rights over part of their business to the other by way of the shareholdings in the joint venture company. The consideration must be at least 25% in the form of ordinary share capital, with the rest being other share capital or debentures. So s 181 cannot apply where there is cash consideration.

A common fallacy is that s 181 only works for 50:50 joint ventures but the legislation actually says that the value of the joint venture interest acquired has to be the same as the value in the business interest given up. So the relief can apply to any joint venture that creates a degrouping situation (ie, anything that leaves one group with less than a 75% holding).

HMRC offers a non-statutory clearance facility 'whenever practicable' (HMRC Manuals CG 45601). An application may be sent directly to HMRC's Capital Gains Technical Group, enclosed with an application for statutory clearances made to AAG (Clearance & Counteraction Team) in connection with the transactions, or sent to the group's normal tax office. My experience has been that HMRC generally takes a common-sense view of the applicability of s 181.

It is important to note that this exemption only applies to capital gains tax and to the intangibles legislation. There is no similar relief in respect of stamp duty land tax and there can also be issues with VAT and the TOGC or VAT grouping rules.

Finally, it is also important that the asset transfers be carried out in one go. One recent attempt at a s 181 joint venture failed as it was not possible for either group to transfer all their assets at the same time. Section 181 would only apply to the initial transfers and setting up of the joint venture. After that, any further transfers of assets from the original groups to the joint venture company would, of course, be ordinary disposals out of the group, with appropriate capital gains tax consequences.

## **Mergers of companies**

Under the EU cross-border mergers Directive (Directive 2005/56/EC on cross-border mergers of limited liability companies), all EU Member States are required to permit and to recognise cross-border company mergers. In the UK, this necessitated both new company law to permit cross-border mergers, and full implementation of the Mergers Directive, the relevant EU tax legislation.

The Mergers Directive gives two forms of merger: by acquisition and by formation of a new company. A merger by acquisition involves a company being dissolved without liquidation and passing all its assets to a successor company in return for which the successor company issues shares to the shareholders of the original company. A merger by formation of a new company is very similar except that, instead of one company merging into an existing company, a new company is set up and two or more companies are dissolved without liquidation so that they transfer all their assets to that new company which issues shares to the shareholders of both (or more) original companies. In both cases, a successor company holds all the assets of one or more original companies and has a combined pool of shareholders.

But what about UK company law? Does it permit companies to merge? Companies Act 2006 s 900 tells us that a Court can sanction a scheme of reconstruction of a company and make provision for the company to be 'dissolved without winding up' and for its assets to be transferred to another company. This wording, which dates back to at least the 1948 Companies Act, suggests that UK company law permits transactions that look very similar to mergers by acquisition or by formation of a new company, and I take dissolution without liquidation to be analogous (subject to translation issues) to dissolution without winding up.

An oddity of the legislation is that mergers can also be carried out by liquidation of the transferor company or companies, under Insolvency Act 1986 s 110. This obviously doesn't comply with the EU requirement for the company to be dissolved without liquidation, although there is no policy reason that I am aware of for the EU Directives not to apply to transactions involving voluntary winding up for the purposes of a reconstruction.

For mergers of UK companies, the transactions should be schemes of reconstruction (TCGA 1992 Sch 5AA) and should qualify for the reliefs at TCGA 1992 ss 136 and 139. Many cross-border mergers will also qualify for the UK reliefs, so the legislation to implement the Mergers Directive, TCGA 1992 ss 140E *et seq.* TCGA 1992 merely ensures that there are no gaps, so that the UK legislation is compliant with the EC Treaty and the Mergers Directive.

Sections 140E and 140F both apply to cross-border company mergers, including the formation of European companies (SEs) and European cooperatives (SCEs). And each requires a transferor company to transfer all its assets and liabilities to a transferee company and to 'cease to exist without being in liquidation', to comply with the EU Directives.

Section 140E applies where the assets of a UK company or of a UK trading permanent establishment (PE) are transferred to a company in another Member State which must be, again, UK resident or the assets must be those of a UK trading PE. So the transfer can be, for example, from a UK company to a company resident in another Member State which would have a UK trading PE, from a non-UK company with a UK trading PE to a UK company, or the assets of the UK trading PE of a company resident in one Member State can be transferred to a company resident in another Member State. Where s 140E applies, the assets transfer at no gain, no loss for chargeable gains purposes, very similar to section s 139, which might apply, in any case. Furthermore, I have always understood that these transactions would *prima facie* fall within the scope of s 171, so that s 140E is otiose.

Another question is whether s 140E is wholly compliant with the EU legislation, since it only applies to UK trading PEs, while the Directives are not restricted to trading companies or activities.

Section 140F applies where a UK company transfers the assets of a non-UK business to a company resident in another Member State. Section 140F is not a tax exemption, but credit is given for notional tax that might have been chargeable in the other Member State where the business was carried on, but for the application of the Mergers Directive preventing that Member State charging such tax.

Another way in which the UK's implementation of the Mergers Directive may be defective is the Mergers Directive permits the 'consideration' for the transfer of assets to have a cash element, not exceeding 10% of the nominal value of the shares issued. This is not permissible under ss 140E or 140F.

Finally, there is also shareholder level relief at s 140G, whereby the transactions are treated as being schemes of reconstruction and s 136 can apply. This means that the disposal of shares in the dissolved transferee and the issue of shares by the transferor are treated as a reorganisation of share capital and the shareholders are deemed not to have disposed of any shares. But s 140G only applies where the transactions fall within ss 140E or 140F and there is no relief for the shareholders on a merger between non-UK companies where none of the assets are subject to UK. So, for example, the shareholders of a German company that incorporates its Italian branch into an Italian company would not get any UK capital gains relief.