Analysis
The new s 179 and reconstructions

SPEED READ **TCGA 1992 s 179 (degrouping charge) has long been a trap for the unwary and an obstacle to commercially driven reconstructions and reorganisations. FA 2011 has turned things around so that in some situations, the application of s 179 will now actively be sought so as to gain a step up in base cost without any corresponding tax charge.**

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FA 2011 has recast TCGA 1992 s 179 in many respects. As has been explained in previous articles, the most striking change is that where the de-grouping occasion is a disposal of shares, the chargeable gain or allowable loss on the s 179 disposal is transposed to the shares disposal: s 179(3D).

The purpose of this article is to discuss the application of s 179 in three situations:

- in a reconstruction to which s 139 applies;
- where the corporate shareholder acquires a new holding and TCGA 1992 ss 116(10), 135 or 136 apply; and
- where assets are transferred intra-group in anticipation of a share disposal to which SSE applies.

Section 139

Specific provision is made to cover the interaction of the new s 179 with the application of s 139 (reconstructions) to a disposal of shares and the consequences of this are surprising (though intended). It should, however, be borne in mind that where the transaction falls within CTA 2010 s 1076 (demergers), s 179 does not apply (TCGA 1992 s 192(3)). This may be counted a misfortune because the tax saving opportunities now offered by s 179 are foregone. To set the scene, let us take a case of the type which in the past has required special steps to be taken to avoid the application of s 179:

Propco is a property investment company with two divisions (A and B). The historic cost of each division is £10 million: the present value is £50 million. There are two groups of shareholders (the A group and the B group) and they wish to divide Propco between them. The obvious course is to move the divisions down to new subsidiaries and then liquidate Propco in a reconstruction falling within ss 136 and 139. Pre-FA 2011 that procedure would have resulted in s 179 charges on the assets of both divisions. The standard procedure to avoid the charge would have been to put a Holdco above Propco and transfer the assets of division A to Holdco. After a decent interval, Holdco is liquidated and Propco (owning division B) is transferred to Newco B and the assets of division A to Newco A. There are here no s 179 disposals and the assets of the divisions remain at historic cost.

In order to understand how the obvious procedure (hive-down to subsidiaries) would work out post-FA 2011, it is necessary to understand the fundamental point that the asset that is the subject of the s 179 disposal is still re-based immediately after the intra-group disposal by reference to which the s 179 charge arises. Thus the asset is disposed of and re-acquired at market value. However, the chargeable gain or allowable loss is then transposed to the disposal of shares that gives rise to the de-grouping. The computational consequences of the transposition are that any chargeable gain is added to the consideration for the disposal and any allowable loss is added to allowable expenditure (s 179(3D)). However, where s 139 applies (no gain/no loss disposal) it is specifically provided that the no gain /no loss treatment of that section overrides the transposition: see the newly inserted s 139(1A). Accordingly, any gain transposed to the shares is not charged to tax or carried forward. The shares are simply treated as disposed of and acquired on a no-gain/no-loss basis. Following on the facts given above, Propco forms two subsidiaries; Propco A and Propco B and transfers the A and the B assets to them respectively in return for an issue of shares with a nominal value of £50 million in each case. Propco is then put into liquidation and Propco A is transferred to Newco A and Propco B is transferred to Newco B. Section 179 applies to the A and the B assets on Propco A and Propco B leaving the group. However, under s 139, those shares are disposed of on a no gain/no loss basis and this is of overriding effect. See the Example. Section 139 is, of course, subject to a 'no main purpose of tax avoidance' condition so that any reconstruction aimed at seeking a tax advantage through the operation of s 139 would not achieve that aim.

Share exchanges and reconstructions

As has been seen, the transposition of the asset gain only takes place if the company which acquired the asset is de-grouped by a disposal of its shares. Where the company leaves the group on a share exchange or reconstruction falling within s 135 or 136, the effect of s 127 is that there is no disposal of shares, but for the new s 179 purposes, this treatment is disapplied (s 179(3C)) and the company is treated as leaving the group on a disposal of shares. The transposition of the gain is altered in cases where s 135 or 136 apply so that the gain is carried forward in relation to the

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new shares (s 179(3E)). Thus on a disposal of those shares, the transposed gain is either deducted from the allowable expenditure on those shares or (if the expenditure is insufficient) added to any actual gains. Any transposed loss is added to the allowable expenditure.

Where the company leaves the group on an exchange of shares for QCBs and s 116(10) applies, the exchange is treated as not involving a disposal. This rule is not modified for the purposes of s 179 so the s 179 disposal does not arise on a disposal of shares. There is therefore no transposition of any gain or loss. In para CG45420 of HMRC's draft guidance it is stated that where s 116(10) applies 'the adjustment will be made to the calculation required under s 116(10)(*a*)'. That calculation is made on the assumption of the disposal of the shares for a market value calculation, but that assumption does not mean there is a disposal of the shares for the purposes of the Act, and without such a disposal, the new s 179(3D) cannot apply.

Assets transferred intra-group in anticipation of a share disposal to which SSE applies

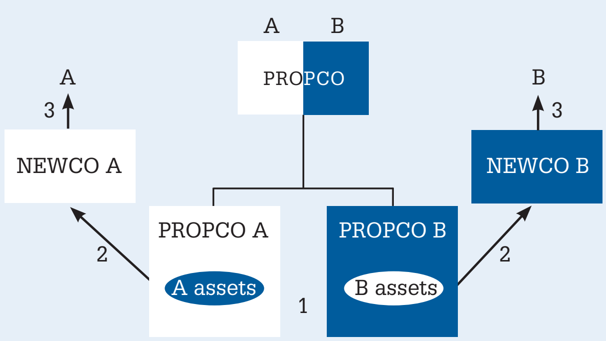
TCGA 1992 Sch 7AC has been amended by the insertion of a new para 15B, the effect of which is to extend the holding period of the company invested in provided certain conditions are satisfied. The practical effect of this is to allow a company to hive down a trade and assets to a newly formed subsidiary and then to sell the shares in that subsidiary with the benefit of SSE notwithstanding that the 12-month holding period for the shares has not been satisfied. One of the conditions is that an asset used in the trade has been previously used in the trade by that company or in a trade by another member of the SSE group throughout the 12 months ending with the date of disposal of the shares. The purpose of this amendment is to allow a company trading through divisions to benefit from SSE by hiving down a business into a Newco without the need to do so more than a year before the sale. The effect of para 15B is not only to allow the sale of the shares to benefit from SSE but also to exempt from tax the s 179 charge on the assets hived down with the trade by adding the s 179 gain to sale consideration which then qualifies for SSE while at the same time rebasing the asset.

SSE is subject to an anti-avoidance rule in Sch 7AC para 5. This has to be borne in mind where it is claimed that a s 179 gain has been transposed to shares which qualify for the exemption. Paragraph 5 applies where, among other things, in pursuance of arrangements an untaxed gain accrues to company A (eg, parent co) on a disposal of shares in company B (eg, hive down co) and before the accrual of that gain there was a significant change of trading activities affecting company B at a time when it was controlled by company A. A significant change includes where company B (ie, hive down co) begins to carry on a trade. The untaxed gain includes the s 179 gain on the arising on the sale which is added to the consideration. Paragraph 5 applies to arrangements from which 'the sole or main benefit' that could be expected to arise is that a gain on the disposal is not a chargeable gain. This test is more restrictive than the usual 'one of the main benefits', but notwithstanding this, there is an obvious tension between the stated intention of the amendments to give companies in these situations the benefit of SSE and para 5. In short, para 5 will usually require an overriding commercial reason for the hive down as in the the following circumstances:

The G group includes G1 which holds the group's trade premises and G2 which trades from a property owned by G1. A sale of G2 is envisaged but a buyer would wish to acquire the trade premises also. Accordingly, the trade premises are transferred to G2 and G2 is then sold. The shares in G2 qualify for the exemption subject only to para 5. The authors understand that in these circumstances, HMRC would not regard para 5 as being in point as the intra group transfer is made to achieve a package suitable for sale. On that basis, the trade premises would be re-based and the gain transposed to the shares would be exempt. ■

In some situations, the application of s 179 will now actively be sought so as to gain a step up in base cost without any corresponding tax charge

Example



1. Propco transfers the A and B assets to Propco A and B respectively.
2. Propco is put into liquidation and Propco A and Propco B are transferred to Newco A and Newco B respectively.
3. Newco A and Newco B issue shares to A and B respectively.

Thus we find that:

- The assets of the two divisions are re-based to market value
- The shares in Propco A and Propco B are acquired by the respective Newcos at historic cost to Propco, namely, £50m in each case without the addition of the s 179 gains
- At shareholder level, s 136 applies and the shares in Newco A and Newco B are treated as the same shares as the original shares in Propco