Focus on Hive Outs for Tax Efficient Corporate Reconstructions

by Mairéad Hennessy

Over time as companies grow, it is common that more than one business is carried on under the umbrella of a single company. Frequently a time will come when the shareholders will want the separate businesses to be operated in separate companies. Such restructuring typically arises in a number of scenarios such as:

- To facilitate external investment in one of the businesses.
- To facilitate succession planning for the shareholders.
- To enable the shareholders maximise their value in each business in the event of a future sale.
- To segregate the risks attaching to each business and avoid cross contamination should one business fall into difficulty.

A common way to carry out this business separation is by way of so-called "Share for Undertaking Three Party Swap" whereby the company transfers one of its businesses to a newly incorporated company in consideration for the new company issuing shares in it to the shareholders of the transferor company. This type of reconstruction is commonly referred to as a "hive out".

Tax implications of a hive out

There are numerous taxes that need to be considered in advance of implementing a hive out. However, the Irish tax legislation provides for reliefs meaning that the hive out can be done on a tax neutral basis where it is structured correctly.

The taxes to be considered before a hive out is implemented are as follows:

- Capital Gain Tax (CGT) for the transferor company on the disposal of its assets,
- CGT for the shareholders of the transferor company on the effective disposal of part of their investment in the transferor company,
- Transfer of corporation tax losses and assets at tax-written-down value from the transferor company to the new transferee company,
- Stamp duty for the new transferee company on the transfer of assets from the transferor,
- Income tax on the distribution of assets to the shareholders,
- VAT; and
- Tax clearance Requirements.

We will analyse below how each of these taxes may be relieved to ensure that the hive out is carried out without any tax cost for the shareholders, the transferor company or the new transferee company.

CGT for the Transferor Company

In general, the transfer of chargeable assets from one company to another gives rise to a CGT charge for the transferor company. However, section 615 Taxes Consolidation Act(TCA)1997 provides that, where the necessary conditions are satisfied, the transfer of chargeable assets from one company to another is deemed to take place for consideration such that no capital gain or loss arises.

The main conditions for section 615 TCA are as follows:

- There is a scheme of reconstruction or amalgamation and the transaction occurs as part of that scheme;
- The transfer must constitute the transfer of the whole or part of the transferor's business;
- Both the transferor and transferee companies must be resident in Ireland, or the assets are chargeable assets immediately before and after the transfer;
- The transferor company receives no consideration for the transfer other than the recipient taking over the whole or part of the liabilities of the business, and
- The transfer of all or part of the transferor company's business is effected for "bona fide commercial reasons and does not form part of an arrangement the main purposes, or one of the main purposes, of which is the avoidance of liability to tax".

There is no clawback of section 615 relief where the shares or undertaking are sold after the reconstruction.

CGT for the Shareholders

A potential charge to CGT arises for the shareholders on the effective disposal of part of their investment in the transferor company to the new transferee company. However, relief from such CGT charge exists under

section 587 TCA 1997 where shares are issued to the shareholders under a bona fide reconstruction which is effected for commercial reasons and does not form part of any arrangement or scheme of which the main purpose is the avoidance of tax.

Where section 587 relief applies, the gain on the old shares is effectively deferred until the new shares are sold by the new transferee company. In order for the relief to apply the sole consideration for the transfer must consist of the issue of shares in the capital of the new transferee company in the same proportion (or as nearly as may be in proportion) to their existing shareholding in the transferor company so that as a result of the reconstruction, substantial ownership of the business transferred remains the same. The assumption of liabilities by the transferee company does not prevent the application of section 587 CGT relief.

Transfer of corporation tax losses and assets at tax written down value

In general, the transfer of a trade between companies triggers an automatic discontinuation of the trade for tax purposes. This means the transferor company is entitled to terminal loss relief and the new transferee company cannot benefit from any unused trading losses.

However, where section 400 TCA 1997 applies the losses of the transferor company that relate to the trade being transferred may be transferred to the new transferee company. The main condition for section 400 to apply is that 75% of the shareholders in the new transferee company must also be shareholders in the transferor company in the three-year period starting one year before and ending two years after the transfer of trade (section 400(5)(a)(i) TCA 1997).

Where the new transferee company acquires a trade from another company under a scheme of reconstruction and losses transfer with that trade then the acquired trade is ring-fenced from other existing trade in New Co and the losses can be carried forward against the same profits from that "notionally" separate trade. There are various methods used in practice to ensure that the ring-

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fenced losses are allocated against the correct trade (i.e. turnover, head count etc.).

Where section 400 applies, plant and machinery may be transferred at tax written down value without triggering any clawback of capital allowances previously claimed by the transferor company. Where the transferred assets are subsequently sold by the new transferee company, any balancing allowance or charge will be given to or made on the transferee company as if it had owned the assets since they were originally acquired by the transferor company.

Stamp duty

Stamp duty can arise on the transfer of assets, goodwill, trade debtors from one company to another. Relief is available from stamp duty under section 80 where the trade is transferred to another company and

- The reconstruction is carried out for bona fide commercial purposes and not for the purposes of avoiding tax and the reconstruction will be on such terms that will ensure substantial continuity of ownership.
- The assets being transferred constitute an "undertaking" or part of an "undertaking".
- At least 90% of the consideration for the transfer must consist of the issue of shares by the transferee company to the shareholders of the transferee company i.e. cash cannot exceed 10% of the total value of the consideration.
- The transferee company is a limited company that is incorporated in an EU / EEA Member State.

The assumption by the transferee company of liabilities of the undertaking being transferred does not preclude the application of this section.

Where the conditions for the relief are satisfied, a stamp duty return must be filed within 30 days (44 days by Revenue concession) of the transaction and the relief claimed on this return.

There is no clawback where the shareholders dispose of their shares within 2 years of the reconstruction.

Income tax on the distribution of assets to shareholders

In a hive out, the shareholders of the transferor company receive shares in the new transferee company without providing consideration directly (i.e. the consideration is provided by the transferor company). Where the shareholders did not already own shares in New Co, this cannot constitute a distribution under section 130 TCA 1997.

Further, Revenue has set out in Tax Briefing 48, June 2002, that it is not the practice of the Revenue Commissioners to invoke a distribution charge where a bona fide reconstruction takes place to which the provisions of section 587 and 615 TCA 1997 apply.

VAT

VAT should also not arise on the asset transfer, as Transfer of Business Relief should apply under ss 20(2)(c) and 26 of the VATCA 2010. This relief automatically applies where the totality of the assets transferring constitute an undertaking capable of carrying on an independent economic activity.

Tax Clearance

A CG50 will be required in respect of the asset transfer where the consideration exceeds €500,000 and there is goodwill and / or Irish property transferring as part of the trade.

Conclusion

In summary, numerous tax considerations arise when shareholders restructure their business operations. When carefully planned, the restructure should not give rise to any tax cost. To this end, it is very important that a full review of the relevant taxes and available reliefs is undertaken before the restructure is implemented to ensure that no tax cost is inadvertently triggered for the parties. Furthermore, both legal and accounting advice must be sought by the shareholders in advance of any corporate transaction.

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