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Corporate trade & asset sales: A beginners' guide - Part 2

1. Overview

These notes accompany Part 2 of our e-CPD module on corporate trade and asset sales. It is a beginner's guide to the tax consequences of the sale by a company of its trade and assets to an unconnected third party.

The first module started by explaining what an asset sale is. It went on to look at some of the wider commercial implications of an asset sale and ended with a discussion of the tax consequences of the disposal of trading stock and chargeable gains assets in the context of such sales.

This module will look at the tax treatment of the sale of intangible fixed assets (including goodwill and know-how) and capital allowance assets before moving on to consider the implications of a trade and asset sale for tax losses, VAT and SDLT.

2. Intangible fixed assets

The disposal of an *intangible fixed asset* (IFA) in the course of a trade and asset sale gives rise to an income profit of either a trading or non-trading nature depending on the nature of the asset's use within the business. The distinction for tax purposes between capital and revenue expenditure is of no significance for these purposes. In most cases, the taxable profit or loss is the accounting profit recognised by the company in its financial statements. Further adjustments may however be required, e.g. in relation to goodwill, or where the tax and accounting base costs of an asset are not the same following a prior claim for IFA *roll-over relief*.

Where roll-over relief is available, a gain on the sale of an IFA can be rolled-over into expenditure on new IFAs incurred in a four year period beginning one year before the date on which the gain arises. This is less likely to be relevant where the intention is to wind-up the company after the sale but should not be ruled out entirely.

3. Goodwill

The sale of the trade and assets of a business will generally involve a disposal of the goodwill in the business. This disposal can be taxed under the chargeable gains rules or the IFA rules so it is important to clearly identify which of these rules will apply. This depends in turn on the date on which the goodwill was acquired or, in the case of internally generated goodwill, the date on which the business commenced.

A disposal of goodwill falls within the chargeable gains rules if the goodwill was created or acquired before 1 April 2002. For this purpose, all of a company's internally generated goodwill is treated as created before 1 April 2002 if the company's business was carried on before that date.

Goodwill created or acquired from an unrelated party on or after 1 April 2002 is taxed as an IFA as is goodwill acquired from a related party who created or acquired the goodwill from an unrelated party on or after 1 April 2002.

In calculating the gain or loss arising on purchased goodwill within the IFA rules, it will be necessary to adjust the original purchase consideration for expenditure (if any) that has already qualified for IFA amortisation relief. Whether, and the extent to which, amortisation relief is available depends on the date the goodwill was acquired. This is beyond the present scope but the position can be complicated as the rules have changed a number of times in recent years.

4. Know-how

As we saw in Part 1 in relation to goodwill, *know-how* is capable of falling within either the IFA rules or the chargeable gains rules depending on whether or not it is a pre-FA 2002 asset, i.e. one that was created or acquired before 1 April 2002. Know-how falling outside the IFA rules, and sold as part of the sale of part (or all) of a trade can be treated in one of two ways:

- By *default*, consideration received on the sale of the know-how is treated as a *capital receipt for goodwill* (and a chargeable gain will therefore arise) on condition that the *know-how* has been used in the company's trade and that know-how is sold by the company as part of the disposal of all (or part) of that trade*; or*
- By *joint election* of the seller and purchaser, the default chargeable gains treatment may be disapplied and the consideration is treated as a *trading receipt* (on condition that the know-how has been used in the company's trade and has not been treated as a disposal of know-how on which *capital allowances* have been claimed).

This election can therefore increase the amount of the overall gains taxed as income and reduce the amount taxed as a chargeable gain by an equivalent amount. This can be beneficial if losses brought forward from earlier accounting periods are available to relieve trading income but not chargeable gains. This is much less relevant now that carried forward *post-1 April 2017* trading losses can be relieved against *total profits* of later accounting periods but may still be beneficial from time to time, e.g. where the conditions for carry-forward relief against *total profits* cannot be satisfied, or where the loss is a *pre-1 April 2017 loss*.

For completeness, it is worth noting that pre-FA 2002 know-how sold otherwise than as part of the sale of part (or all) of a trade will normally be taxed as a trading receipt.

5. Capital allowances: disposal value

To the extent that an asset sale involves the sale of assets on which capital allowances have been claimed, a disposal event will arise for capital allowance purposes. The *disposal value* to be brought into account on the disposal of capital allowance assets is:

- *market value* where the sale is for less than market value; the purchaser cannot claim plant and machinery (or research and development) allowances and there is no related employment income charge;

- *market value* where the purchaser is a connected *dual resident investing company* and there is no related employment income charge; or
- in all other cases, *the net proceeds of sale* plus (if any) insurance proceeds received as a result of an event affecting the price obtainable on sale.

For these purposes, if an asset is sold together with other assets, the *net proceeds of sale* is determined on the basis of a *just and reasonable apportionment* of the net proceeds of sale of all the assets. Furthermore, all property sold as a result of one agreement is treated as sold together, even though separate prices are agreed for separate items of that property, or there are separate sales of separate items of that property.

6. Capital allowances: balancing adjustments

The disposal of capital allowance assets unconnected with the cessation of a company's trade does not normally give rise to balancing adjustments and, in such cases, the *disposal value* (determined below) would simply be deducted from the balance of expenditure in the relevant capital allowances pool.

Where however, as in the case of an asset sale, capital allowance assets are disposed of in connection with the cessation of a company's trade, balancing adjustments will arise in all relevant capital allowance pools representing the difference between the *disposal value* and the *tax written down value* of the pooled assets. A balancing charge increases taxable trading profits or reduces a trading loss. Likewise, a balancing allowance reduces trading profits or increases a trading loss.

Note that the annual investment allowance, writing-down allowances and first-year allowances are not available in the accounting period in which the trade ceases.

It will generally be beneficial to seek to minimise the disposal proceeds attributable to capital allowance assets, thereby maximising the value of capital allowances already claimed and minimising any balancing charges arising, but this will not always be the case.

7. Capital allowances: fixtures

Where an asset sale includes properties containing *fixtures* eligible for *capital allowances*, it is important to ensure that the seller has maximised the value of any allowances to which they are entitled but may not perhaps have claimed. It may also be important to help put the purchaser in a position to claim capital allowances on the fixtures they will acquire as a result of the asset sale.

With regard to unclaimed allowances of the seller, there is no general time limit restricting claims for plant and machinery allowances. So, if an asset was bought 20 years ago and no claim has been made for plant and machinery allowances, it is still possible to claim. The old expenditure can simply be added to other qualifying expenditure for the year in which the claim is made,

although the asset must be owned the company at some time in the accounting period in which the claim is made.

The position is more complicated if the seller has acquired second-hand fixtures on or after 6 April 2012 and wishes to claim allowances thereon. This is because of the requirement to satisfy both the *pooling requirement* and the *fixed value requirement,* the latter of which requires a CAA 2001, s. 198 election to be made within 2 years of the date on which the seller acquired its interest in the fixtures (or to have applied to the Tribunal within the same period to determine the tax value of the fixtures). The position becomes more complicated if the seller acquired the fixtures from a party not entitled to claim allowances but this is beyond the present scope.

The *pooling requirement* requires broadly that the past owner of a property must allocate their original expenditure on the fixtures into a capital allowances pool. As this can only be done for accounting periods in which a claimant owns the fixtures in question, this must be done no later than the accounting period in which the sale takes place, thereby imposing a further effective deadline.

If one or both of the *pooling requirement* or the *fixed value requirement* is not satisfied in relation to the fixtures in question, the seller will simply be unable to claim allowances. Remember however that these provisions only apply to purchases of second-hand fixtures. So, for example, they do not apply where the seller constructed a new building or refurbished an existing property with new fixtures.

The purchaser (in relation to the asset sale) is also likely to want to make sure that they, in turn, can claim allowances in relation to their own expenditure. Compared to the seller's position above the tables are now reversed and the seller may need to help the purchaser satisfy both the *pooling requirement* and the *fixed value requirement*. A well-advised purchaser is likely to want the satisfaction of these requirements addressed in the asset sale agreement.

As we have seen, the *fixed value requirement* requires the buyer and seller to mutually agree the value of the sale consideration attributable to fixtures (although it may not be higher than the capital expenditure treated as incurred by the seller on the provision of the fixture, or the actual sale price). There can be considerable scope for adding value in asset sale situations by careful consideration of this attribution. It will generally be beneficial to minimise the disposal proceeds attributable to capital allowance assets, thereby maximising the value of capital allowances already claimed and minimising any balancing charges arising. This will not always be the case and if the seller cannot use the additional allowances it may be possible to pass the benefit of higher allowances to the purchaser in return for an enhanced overall sale price. Either way, it is generally recommended that the apportionment of the sale consideration should be documented in the sale agreement for clarity and the avoidance of disputes.

8. Losses: terminal losses

The cessation of a company's trade caused by the sale of its trade and assets means that *terminal loss relief* may be available in relation to any trading losses incurred in the final 12 months of trading.

Where the conditions for relief are satisfied, a trading loss incurred in the final 12 months of trading (the *terminal loss*) can be set off against the trading income of the company made in the three preceding years. If the final accounting period is less than 12 months, a proportionate part of the trading losses arising in the penultimate accounting period can also be relieved. Terminal loss relief is also extended in certain circumstances to a trading loss carried forward to the terminal period of the company.

Unused losses are lost. They cannot be carried forward for the benefit of the purchaser except in certain situations involving *common ownership* of both seller and purchaser (beyond the present scope).

9. VAT

The sale of a company's trade and assets will usually qualify as a *transfer of going concern* (TOGC) for VAT purposes. This means that no VAT is charged on the sale of the trade and assets as the supplies made will be outside the scope of VAT. HMRC is no longer prepared to give informal rulings on whether "straight forward" transactions qualify as a TOGC. The seller should therefore protect its VAT position by ensuring the consideration is expressed in the sale agreement as being exclusive of VAT.

10. SDLT

A *stamp duty land tax* charge, a *land and buildings transaction tax* charge (Scotland), or a *land transaction tax* charge (Wales) may arise where the assets to be sold include property interests. The general rule is that the chargeable consideration is any consideration in money or money's worth given directly or indirectly by the purchaser. Chargeable consideration includes the release or assumption of a debt.

Although this is a cost for the buyer, you should consider the implications this may have on the total purchase consideration that the buyer is prepared to pay for the assets of the business. This would clearly be a significant deterrent to an asset sale of a property-rich business.

11. Further reading

Navigate Tax module: Selling the business: Trade and assets
Navigate Tax module: Selling the business: Shares

In-Depth content on the intangible fixed asset (IFA) rules
In-Depth content on disposal of know-how
In-Depth content on capital allowances
In-Depth content on terminal losses
In-Depth content on VAT transfer of going concern
In-Depth content on SDLT
In-Depth content on LBTT (Scotland)
In-Depth content on LTT (Wales)