



If you operate a company that manages a number of different strands, trading activities, you may want to split the business into separate companies, each dealing with a different business activity. UK tax legislation contains provisions to facilitate transactions in this way and that enables trading activities which are carried on by a single company or a group to be divided so that they may be carried on by two or more companies which do not belong to the same group or by two or more independent companies.

The process is generally known as a company demerger.

Demergers can be used to transfer parts of a business to operate independently or be sold off. There are different routes by which a demerger can be achieved. This note focuses on the statutory route.

To achieve a demerger, a company would normally make a distribution. The statutory provisions provide that where certain conditions are met, the distribution is an 'exempt distribution', i.e., one that is not treated as a distribution for tax purposes.

## General requirements

For the statutory rules to apply, a number of general conditions must be met.

1. Companies involved in the transactions must be UK resident or resident in a member State at the time that the distribution is made.

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2. The distributing company and the company whose shares are distributed must be a trading company or a member of a trading group.
3. The distribution must be made wholly or mainly for the purposes of benefitting some or all of the trading activities which before the distributions were carried on by a single company or group and after the distribution will be carried on by two or more companies and groups.
4. The distribution must not form part of a scheme or arrangement, the main purpose or one of the main purposes of which is the avoidance of tax, the making of a chargeable payment, the acquisition of the distributing company or another relevant company other than by members of the distributing company or the cessation or sale of the trade after the distribution.

The statutory provisions provide for different types of demergers.

## **Direct demerger**

A direct demerger is where there is a distribution by a company of its shares in one or more 75% subsidiaries.

For the distribution to be treated as an exempt distribution, the distributed shares:

- must not be redeemable;
- must constitute the whole or substantially the whole of the distributing company's holding of the subsidiary's ordinary share capital; and
- must confer the whole or substantially the whole of the distributing company's voting shares in the subsidiary.

After the distribution, the distributing company must be a trading company or the holding company of a trading group; unless the distributing company is a 75% subsidiary of another company, the distribution involves two or more of the distributing company's 75% subsidiaries and the distributing company is dissolved without any net assets available for distribution on the winding up.

## **Tax implications of a direct demerger**

Where there is a direct demerger that meets the statutory conditions, the distribution is exempt from income tax in the shareholders' hands. In addition, there is no immediate capital gains tax liability as any gain is effectively rolled over.

As long as the substantial shareholder exemption applies, any capital gain by the distributing company is not taxable.

There is no VAT or stamp duty to pay.

## **Indirect demerger**

An indirect demerger is where there is a transfer of the trade or the shares in the company that is to be demerged to a newly-incorporated company. The new company then issues shares to the shareholders of the distributing company.

Again, to benefit from the favourable tax treatment offered by the statutory rules, certain conditions must be met.

Where the trade is transferred, the distributing company must not retain any interest in the trade or only retain a minor interest.

Where the shares are transferred, the shares must comprise the whole or substantially the whole of the distributing company's ordinary share capital of the subsidiary and also the whole or substantially the whole of the distributing company's voting rights.

After the distribution, the only or main activity of the new company must be the carrying on of the trade or the holding of the shares that were transferred to it.

The shares issued by the new company must not be redeemable and they must constitute the whole or substantially the whole of its issued ordinary share capital and its voting rights.

As with a direct demerger, after the distribution, the distributing company must be a trading company or the holding company of a trading group, unless the distributing company is a 75% subsidiary of another company, the distribution involves two or more of the distributing company's 75% subsidiaries and the distributing company is then dissolved without any net assets available for distribution on the winding up.

## **Tax implications of an indirect demerger**

Where the statutory conditions are met, the distribution is exempt for income tax purposes in the hands of the shareholder and any capital gains are effectively rolled over.

There is no exit charge on the distributing company.

Where the distribution is to all members, there is no stamp duty.

There is no VAT chargeable on the distribution.

## **Cross border demergers**

The statutory provisions also provide for cross border mergers, but these are outside the scope of this note.

## **Chargeable payments**

When planning a demerger, you will also need to give thought to potential future transactions. To discourage the use of demergers for tax avoidance purposes, a chargeable payment is treated as a distribution if it is made within five years of an exempt distribution. The definition of a chargeable payment is broad and includes a direct or indirect payment or transfer of money or money's worth in connection with the shares of the company to the members of the company or, where the company is unquoted, to anyone, other than:

- a distribution,
- an exempt distribution,
- payments made to members of the same group, and
- payments made for genuine commercial reasons.

## Miscellaneous requirements

**Clearance procedure** - A company thinking of demerging can apply to HMRC for advance clearance.

**Returns** - Where an exempt distribution is made, you must make a return to HMRC within 30 days providing details of the distribution and the reason why it is exempt.

## We can help

If you have a good commercial reason for demerging any of your existing activities, we can advise how to organise the demerger without triggering unnecessary tax liabilities.

Please call us on **01753 888 211** or email **info@nhllp.com** for an initial discussion of your objectives.