# The Chartered Institute of Taxation

## Application and Professional Skills

## Taxation of Larger Companies and Groups

## November 2021

## Suggested solution

**Report to the Board of Dubfast & Glasburgh Group plc**

**Disposal of Retail Properties**

## Introduction

This report addresses the issue of how the group should dispose of its retail properties.

The Board has decided to realise value from the disposal of all our retail properties but continue to trade from them as tenants for the next ten years. Over a period of ten years, the group will withdraw from high street retailing and invest in developing a new online retail business model.

This report considers four different options for disposing of the retail properties and recommends the method that will maximise the post-tax sale proceeds and best meet the commercial objectives.

The report has been prepared using information in Berdad Partner's report of 15 October 2021 and information available to the group's tax department on the profile of the group and the tax and commercial history of its properties.

Valerie Johnson
Tax Director
November 2021

## Executive Summary

The objectives are to dispose of our retail properties as quickly as possible before the anticipated, gradual decline in the value of retail properties generally and to maximise post-tax proceeds to fund the proposed investment programme in the on-line business while gradually exiting from High Street retailing.

The simplest method of disposing of all the retail properties is to sell them directly, either to a single buyer or to several buyers. This would yield pre-tax sale proceeds, after settling outstanding loans, of £1,130 million and a tax liability of £4 million.

However, all the properties need to be sold quickly to avoid holding any assets that are falling in value. Holding assets would jeopardise funding of the investment programme. Therefore, if a quick sale cannot be achieved of all properties, a sale of a company owning all the properties is recommended.

Disposal of DG Propco Ltd might yield slightly higher net proceeds of £1,170 million because of sharing the SDLT saving to the buyer but would generate a significantly higher tax liability that would more than eliminate the additional sale proceeds that could be negotiated. Potentially risky warranties and indemnities would also have to be given.

Transferring the properties to a Newco and selling Newco would realise £1,130 million before tax, but again with a significantly higher tax liability than a direct asset sale.

Transferring the properties to Newco and then inviting share subscriptions to Newco from external investors, overall proceeds of £1,130 million could be generated, although the tax liability would be the same as transferring the properties to Newco and selling it. Although there is a significantly higher tax liability than a direct asset sale, potential investors will not have to pay any Stamp Duty in respect of the shares issued to them.

There are no VAT consequences of whichever disposal method is used.

It is therefore recommended to first try to sell all the properties direct, and if that cannot be achieved, to transfer them to a Newco and invite external investment.

**The Structuring Options**

There are four options to consider:

<u>1.Sale of properties</u>

Following the sale of the properties, we would continue to occupy the premises as tenants for up to ten years, under leases entered into with the new owners.

Disposals of all properties at market value would yield £1,130 million after repaying outstanding loans (£1,730 million less loans of £600 million), before tax and disposal costs.

<u>2. Sale of DG Propco Ltd</u>

Following the sale of DG Propco Ltd, we would continue to occupy the premises as tenants. New leases might be required to limit our tenancy to 10 years, and to set rents at market value (insofar as they are not already).

Disposal of the company at market value would yield £1,130 million (£1,100 million net asset value at 31 December 2020 plus £30 million increase in valuation of properties to the current time), subject to tax and disposal costs.

<u>3. Transfer properties to Newco and sale of Newco</u>

The properties, together with the debt secured on them, would be transferred to a Newco and new ten-year leases entered into between Newco and our trading subsidiaries, at market rents.

If the properties were transferred at their current market value, the consideration given by Newco could be debt of £1,130 million (market value £1,730 million less debt £600 million), or an issue of shares worth £1,130 million or a mixture of debt and equity.

Alternatively, the properties could be transferred at current book values of £1,700 less debt of £600 million net £1,100 million, again for debt or equity of £1,100 million or a mixture thereof.

If Newco acquired the properties at market value, Newco could be:

a) sold for a nominal £1, with the buyer injecting £1,130 million cash to Newco to enable it to repay the £1,130 million debt; or
b) sold for the market value (which will be up to £1,130 million) to the extent Newco has issued shares, with the buyer injecting sufficient cash to enable Newco to repay any debt element of the property purchase price.

If Newco acquires the properties at book value, an additional £30 million would be payable for the shares to reflect the increase in market value of the properties to £1,730 million over book value of £1,700 million.

Cash proceeds received would total £1,130 million however Newco is structured.

4. Transfer properties to Newco and invite external investors' share subscriptions

The properties would be transferred to Newco at market value (£1,730 million less £600 million debt) for an equal amount of debt of £1,130 million. Newco would have only nominal share capital of say £100.

Investors would then be invited to subscribe for £1,130 million of new shares in Newco. The investors would then own almost all the share capital of Newco. Newco would use the cash of £1,130 million subscribed to repay its debt to DG Propco Ltd. The group would therefore receive consideration equal to the net value of the properties.

Before investors subscribe for shares in Newco, new ten-year leases would be entered into between Newco and our trading subsidiaries, at market rents.

**Corporation Tax**

Option 1 – Sale of properties

*Corporation Tax on chargeable gains*

Detailed individual property computations would be required in due course. Based on currently available information, an aggregate position can be estimated as follows, subject to any deductible incidental disposal costs:

Table 1

| | Properties acquired before March 1982 | Properties acquired after March 1982 |
|---|---|---|
| | £ million | £ million |
| Sale proceeds | 750 | 980 |
| Less market value at 31 March 1982 | (200) | - |
| Less cost | - | (300) |
| Less indexation | Note 1 (500) | Note 2 (190) |
| Chargeable gains | 50 | 490 |

Note 1: Indexation allowance from March 1982 to December 2017 is about 2.5 times March 1982 value. No further indexation accrues after December 2017.

Note 2: Taking the average acquisition date as July 2000, indexation allowance would be about 0.63 times cost.

The properties have been used by the group for the purposes of a trade. Therefore, the gains realised by DG Propco Ltd (which as a member of the Dubfast & Glasburgh Group is deemed to carry on a trade) could be rolled over against the cost of new tangible assets to be used in a trade, being land and buildings and depreciating assets such as fixed plant and machinery. Rollover relief is not available in respect of intangible assets such as software or the cost of the feasibility studies in 2021. For a gain to be rolled over in full, all the sale proceeds must be reinvested in the period beginning one year before and ending three years after the sale.

A gain rolled into a non-depreciating asset reduces its base cost for a future disposal, whereas a gain rolled into depreciating asset is deferred until the earlier of the date of disposal of the new asset or ten years from its acquisition. Gains so deferred under the latter form of the relief can be rolled over into non-depreciating assets acquired within the qualifying time period of the original disposal.

All the sale proceeds of the Category B properties, £980 million, could be reinvested in the proposed warehouse developments totalling £980 million in 2022, 2023 and 2024, thus sheltering £490 million of capital gains.

The remaining gains of £50 million could be elected to be transferred to Dubfast & Glasburgh Group plc to access its capital losses carried forward of £400 million. Relief for those losses would be restricted to £27.5 million (i.e. 50% of chargeable gains after the first £5 million of gain (assuming that the group's deductions allowance has been claimed and allocated to that company)), leaving £22.5 million liable to Corporation Tax.

*Capital allowances*

As the buyers would be property investors, they would want to maximise the capital allowance element of their purchase price to obtain immediate tax deductions. Amounts attributed to building fixtures would be deducted from our capital allowances pool, so that any amount over £10 million will trigger a balancing charge liable to Corporation Tax. An election, binding on both parties, can specify any amount up to original cost of £30 million. Elections at original cost would trigger a £20 million (£30 million cost less pool £10 million) balancing charge liable to Corporation Tax.

<u>Option 2 – sale of DG Propco Ltd</u>

*Corporation Tax on chargeable gains*

The capital gain on the sale of DG Propco Ltd would be as follows subject to any deductible incidental disposal costs:

| | £ million |
|---|---|
| Sale proceeds | 1,130 |
| Less value at March 1982 | (60) |
| Indexation (2.5 x March 1982 value) | (150) |
| Chargeable gain | 920 |

Because of its long history, this company might have undertaken earlier transactions that could cause value-shifting or depreciatory transaction adjustments to increase the gain.

Shares are not qualifying assets for reinvestment relief purposes, so the gain could not be rolled over. Furthermore, because DG Propco Ltd is an investment company, the substantial shareholdings exemption (SSE) could not be claimed to exempt the gain.

The capital losses carried forward of £400 million could be utilised because this is below 50% of the total gains, leaving £520 million liable to Corporation Tax.

*Capital allowances*

Plant and machinery allowances in respect of building fixtures would continue in DG Propco Ltd and no balancing charge would arise.

Option 3 - Transfer properties to Newco and sale of Newco

*Corporation Tax on chargeable gains*

The intra-group transfer of properties to Newco would be deemed for tax purposes to be at no gain/no loss, so that no chargeable gains/losses arise.

The shares issued by Newco would be deemed to have a capital gains base cost equal to their market value. This would be either £nil, if the consideration given by Newco for the properties transferred were debt; £1,130 million if the consideration were wholly shares; or £1,130 million less the debt element if the consideration were mixed shares and debt.

When Newco leaves the group, it would be deemed to have disposed of and reacquired the transferred properties at the date of the transfer at market value, thus realising capital gains within Newco. Those gains would be as shown in Table 1 above (and total £540 million).

The chargeable gains position on the disposal of Newco shares would be as follows:

a) The consideration at market value, assuming the sale takes place shortly after Newco acquires the properties, would be the same as acquisition cost, so no chargeable gain.
b) The deemed property gains would be added to the consideration received for the shares in computing the gain on the share disposal. Therefore, there would be a chargeable gain of £540 million on the share disposal.
c) The gain cannot be rolled over (as shares are not a qualifying asset) or relieved by SSE (as Newco is not a trading company for SSE purposes).

Losses brought forward would be restricted to 50% of chargeable gains after the first £5 million (again assuming that the group's deductions allowance has been claimed and allocated to that company), leaving £267.5 million (£540 million - £5 million - £267.5 million) liable to Corporation Tax.

*Capital allowances*

Building fixtures are disposed of when the properties are transferred, requiring disposal proceeds to be brought into account. Newco's new owners would want to maximise the capital allowance element of their purchase price as discussed under option 1 (so that a balancing charge of £20 million arises).

Option 4 - Transfer properties to Newco and invite external investors' share subscriptions

*Corporation Tax on chargeable gains*

The intra-group transfer of properties to Newco would be deemed for tax purposes to be at no gain/no loss, so that no chargeable gains/losses arise.

Newco would leave the group as the investors are issued new shares and gain control of Newco.

There is no disposal of the original Newco shares still owned by Dubfast & Glasburgh Group plc and so there is no chargeable gain to consider in respect of those shares.

As with the sale of Newco, there are the same de-grouping gains in respect of the transferred properties. However, as there is no share disposal of Newco, those gains of £540 million are not treated as arising in Dubfast & Glasburgh Group plc. The gains are charged in Newco itself and no roll-over relief is available to defer them.

As is the case for Option 3, however, the of £540 million may be sheltered (in part) by the capital losses carried forward in Dubfast & Glasburgh Group plc so that £267.5 million of the gain is left in charge to Corporation Tax.

*Capital allowances*

The capital allowances position would be as described above on sale of Newco under option 3 (so that a balancing charge of £20 million arises).

**Corporation Tax Summary**

| | Option 1 £million | Option 2 £million | Option 3 £million | Option 4 £million |
|---|---|---|---|---|
| Sale proceeds | 1,730 | 1,130 | 1,130 | - |
| Internal debt repaid | - | - | - | 1,130 |
| External debt repaid | (600) | - | - | - |
| Net proceeds | 1,130 | 1,130 | 1,130 | 1,130 |
| | | | | |
| Chargeable gain | 22.5 | 520 | 267.5 | 267.5~~22.5~~ |
| Corporation Tax thereon | 4.3 | 99 | 50.8 | 50.8~~4.3~~ |
| Possible balancing charge (max) | 20 | | 20 | 20 |
| | | | | |
| Capital losses to carry forward | 372.5 | 0 | 127.5 | 127.5~~372.5~~ |

All four options produce the same pre-tax net proceeds. Option 1 gives rise to the smallest chargeable gain (£22.5 million) compared to much larger chargeable gains on Option 2 (£520 million) and Options 3 and 4 (approximately £268 million in both cases).

Option 1 has the smallest chargeable gain because of the ability to rollover £490 million of the total £540 gains arising. Up to £122.5 of the deferred gain (being 25% of the amount of warehouse expenditure attributed to fixed plant and machinery) relates to the reinvestment in plant and machinery, and so will crystallise when building fixtures are replaced. Other gains might crystallise if the warehouses are sold. We have, however, by adopting Option 1, preserved £372.5 million of the capital losses carried forward in Dubfast & Glasburgh Group plc, which (subject to the available limitation on the relief of such losses) should be available in future to shelter any such crystallising gains.

Option 2 has the advantage that it will not trigger a potential capital allowances balancing charge of up to £20 million, but that is far outweighed by the much larger chargeable gain of £520 million arising, which could yet be increased by depreciatory transactions or value-shifting legislation.

On balance, from a Corporation Tax perspective, option 1 would be better than options 2, 3 or 4.

**Value Added Tax (VAT)**

Option 1 - Sale of properties

Insofar as the buyers intend to carry on the same letting businesses, provided DG Propco Ltd and the buyers opt to tax the property prior to sale and the buyers are or will become VAT registered, the sales of the buildings with existing tenants are transfers of a going concern and as such VAT is not chargeable on the transfers.

Option 2 - Sale of DG Propco Ltd

The sale of shares is exempt from VAT, so that no VAT liability would arise on this transaction.

<u>Option 3 - Transfer properties to Newco and sale of Newco</u>

The intra-group transfer of properties to Newco can be undertaken within the Dubfast & Glasburgh VAT group so long as Newco is brought within the VAT group, so that no VAT is chargeable.

The sale of shares is exempt from VAT and so does not give rise to any VAT liabilities.

<u>Option 4 - Transfer properties to Newco and invite external investors' share subscriptions</u>

The transfers to Newco will be as in 3 above.

No VAT arises on a subscription for new shares.

**VAT Summary**

There are no VAT consequences of any of Options 1, 2, 3 and 4.

**Stamp Duties**

<u>Option 1 - Sale of properties</u>

Stamp Duty Land Tax (SDLT) would be due on the gross consideration payable of £1,730 million. Assuming that each of the 60 properties is worth more than £250,000 most of the consideration would be liable at 5%, giving a liability of about £85 million. SDLT would be an additional cost of the transaction payable by the purchaser or purchasers.

<u>Option 2 - Sale of DG Propco Ltd</u>

No SDLT would be payable.

Stamp Duty is payable at 0.5% on consideration for the transfer of shares. On a sale of DG Propco Ltd at £1,130 million, a liability of £5.65 million would arise, payable by the purchaser.

<u>Option 3 - Transfer properties to Newco and sale of Newco</u>

SDLT is not payable on the intra-group transfers unless there are already arrangements in place at the time of transfer for Newco to leave the Dubfast & Glasburgh SDLT group. Even where no SDLT arises on the intra-group transfers, where the transferee company leaves the group within three years of such transfers the exemption is withdrawn and SDLT liability arises in the transferee company. Newco would therefore become liable in respect of the property transfers when it leaves the group. An SDLT liability of about £85 million (computed as under option 1 above) would arise in Newco, which would be funded by a purchaser of Newco.

Stamp Duty would be is payable at 0.5% of the consideration paid for the transfer of the shares (which might be as high as £5.65 million (½% x £1.130 million). This can be minimised by NewCo buying the properties for debt rather than equity.

<u>Option 4 - Transfer properties to Newco and invite external investors' share subscriptions</u>

SDLT of £85 million would arise on the transferred properties, as described under option 3, as Newco leaves the Dubfast & Glasburgh group.

Stamp Duty is not payable on the issue of new shares. Therefore, no duty would be payable on a share subscription.

Stamp Duties Summary

£85 million of SDLT would be payable under Options 1, 3 and 4. Under Option 3, Stamp Duty of £5.65 million may also possibly arise. Under Option 2, the purchaser is liable to Stamp Duty only, amounting to £5.65 million, a saving of approximately £80 million.

If we were to pursue Option 2, the purchaser would have a stamp duty liability of £5.65 million only, thus saving net £80 million compared to the other options. Under that option, we might reasonably expect in negotiations to share that saving, say £40 million each. That saving could be dealt with as an increase to the proceeds. Alternatively, under the other three options, sale proceeds could be reduced by £80 million, but by only £40 million under option 2. We have assumed the former approach, i.e. an increase in proceeds under option 2.

**Overall recommendations**

Options 1, 3 and 4 would generate pre-tax sale proceeds of £1,130 million after paying off outstanding secured debt. Option 2 might, because of the net SDLT/Stamp Duty savings of a purchaser, yield an extra £40 million of proceeds.

However, the chargeable gain of at least £560 million on Option 2 (£520 million computed above plus additional £40 million proceeds, subject to possible value-shifting and depreciatory transaction adjustments) would create an immediate Corporation Tax liability approximately £55 million higher than Options 3 and 4 and £102 million higher than Option 1. This would be partly set off by the saving due to not having a capital allowances balancing charge of up to £20 million (tax of approximately £4 million). Nevertheless, the additional net tax of £51 million more than absorbs the anticipated additional sale proceeds of £40 million.

Option 1 has the disadvantage that gains of approximately £122 million rolled over against fixed plant and machinery might become liable to tax at a future point in time. However, £372.5 million of capital losses carried forward in Dubfast & Glasburgh Group plc, assuming not subsequently used, should be available to cover any such gains, subject to the restriction on carried forward losses calculated by reference to the deductions allowance. Assuming the deductions allowance is claimed and allocated to Dubfast & Glasburgh Group plc on a subsequent crystallisation of the £122 million deferred gain, a maximum of £58.5 million of chargeable gains, and tax of approximately £11 million, would arise at some future point.

Options 3 and 4 do not involve any rolled-over gains. However, their immediate Corporation Tax charge exceeds that of option 1 by about £46 million.

Accordingly, from a tax perspective it appears that option 1 would be the most favourable one to adopt.

From a commercial perspective, option 1 would be the most straightforward also. However, it might be difficult to sell all of the properties quickly. Buyers are likely to want to acquire only the more attractive sites, leaving us with the others. We would then be exposed to a falling market and unable to generate sufficient proceeds to fund the investment programme (thus jeopardising our overriding commercial objectives).

We should therefore as an alternative consider disposing of a company owning all the properties. Option 2 is unattractive because it yields lower after-tax proceeds. Furthermore, for option 2 we would have to give extensive, and potential costly, warranties and indemnities to any purchaser.

Options 3 and 4 are the other alternatives. Option 4 has a good prospect of success given that there is a market for investment in commercial property portfolios although the after-tax proceeds are the same as for option 3.

In conclusion, an initial attempt should be made to sell all the properties direct (option 1), ideally to a single purchaser. If that cannot be achieved quickly, we should move to undertake option 4 (rather than Option 3). Although from our perspective the after-tax proceeds in relation to both Options 3 and 4 will be £46.5 million lower than for Option 1, Option 4 is more likely to be more attractive to potential investors than Option 3 because they will realise a total Stamp Duty saving of £5.65 million.