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RELEVANT TO ACCA QUALIFICATION PAPER P6 (UK)

Corporation tax and groups
Part 2 – Capital gains groups

This is the Finance Act 2012 version of this article. It is relevant for candidates sitting the Paper P6 (UK) exam in 2013. Candidates sitting Paper P6 (UK) in 2014 should refer to the Finance Act 2013 version of this article (to be published on the ACCA website in 2014).

This is the second of two articles on corporation tax and groups; the first covered group relief.

Groups of companies are an important aspect of corporation tax within Paper P6 (UK). Having studied the basics of this area at Paper F6 you are now expected to progress to more advanced aspects. However, the basic rules continue to be of vital importance as they are the foundation on which the additional rules rest. You must have a sound knowledge of the many rules within this subject if you are to be able to handle an exam question involving groups.

This is not an introductory article; it is relevant to students coming to the end of their studies and finalising their preparations to sit the exam. It begins by briefly summarising the rules relating to both group relief groups and capital gains groups. It then goes on to consider various issues relating to capital gains groups that could be introduced in an exam question. It does not include comprehensive explanations of the rules but assumes a reasonable knowledge.

This article is intended to be read proactively – ie statements made should be confirmed as true by reference to the reader's understanding of the rules or to a relevant study text. This approach will enable future situations to be analysed from first principles rather than by reference to a rigid set of memorised planning points.

The basic rules

The structure of the Q Ltd group of companies is set out in Figure 1. It should be assumed, at least to begin with, that all of the companies are resident in the UK. The minority shareholders in the group companies are companies with no relationship with Q Ltd.

You should be able to review the group structure and confidently identify the members of any group relief groups and capital gains groups. Try to do this before you read the information in Table 1.

FIGURE 1: STRUCTURE OF THE Q LTD GROUP OF COMPANIES

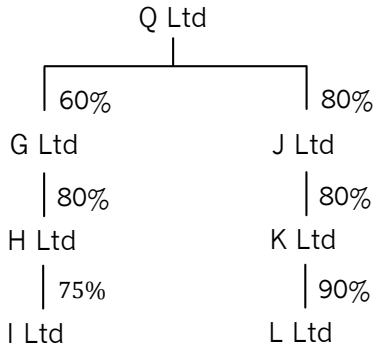

TABLE 1: GROUP RELIEF AND CAPITAL GAINS GROUPS RE FIG 1

	Group relief group	Capital gains group
The groups	There are five separate group relief groups. • G Ltd and H Ltd • H Ltd and I Ltd • Q Ltd and J Ltd • J Ltd and K Ltd • K Ltd and L Ltd.	• Q Ltd, J Ltd, K Ltd and L Ltd form a capital gains group. • G Ltd, H Ltd and I Ltd form a separate capital gains group.
Rationale	There is no group of more than two companies because, excluding immediate subsidiaries, no company has an effective interest of at least 75% in any other company.	• The effective interest of a principal company in a non-directly held subsidiary needs only to be more than 50%. • Q Ltd is not in a group with G Ltd because it does not have a direct 75% interest in G Ltd.

Once a capital gains group exists:

- Chargeable assets are transferred between group companies at no gain, no loss. This is automatic and no election is required.
- An election can be made to transfer the whole or part of a chargeable gain or allowable loss from one group company to another.
- All of the companies in the group are treated as a single company for the purposes of rollover relief.
- In addition, intangible fixed assets are transferred at a value that gives rise to neither a profit nor a loss. This is automatic and no election is required.

Before you study the further issues set out below, answer the following mutually exclusive questions on the Q Ltd group.

1. Q Ltd wants to increase its holding in G Ltd with the aim of bringing all of the group companies into a single capital gains group; what must Q Ltd's new holding in G Ltd be?
2. What are the capital gains group implications of L Ltd owning 85% of an additional company, M Ltd?

The solutions to these questions are set out at the end of this article.

Companies resident overseas
Companies resident overseas are included within a capital gains group. However, the advantages available to such groups are restricted to companies resident in the UK or companies resident overseas which have a permanent establishment in the UK. If K Ltd in the Q Ltd group were owned by J Inc, a company resident and trading outside the UK, rather than J Ltd, the members of the Q Ltd capital gains group would not change. However, no gain, no loss transfers, and the other advantages of capital gains groups, would only be available between Q Ltd, K Ltd and L Ltd and between G Ltd, H Ltd and I Ltd as before.

Transfers at no gain, no loss
The transfer of assets between companies in a capital gains group at no gain, no loss should not be regarded as a tax planning opportunity. This is because there is no need to transfer assets in order to realise a chargeable gain or allowable loss on an external sale in a particular group company; the gain or loss can be transferred to the appropriate group member after the event simply by submitting an election (see below). The no gain, no loss transfer rule enables the management of a group of companies to carry out commercial transactions, for example, the transfer of an asset, or even a whole trade, from one company to another without giving rise to any chargeable gains. Similar rules ensure that no stamp duty or stamp duty land tax arises on such transfers although the effective ownership required in non-directly held subsidiaries is 75% as opposed to more than 50%.

The substantial shareholding exemption (SSE)
The SSE is given automatically where there is a sale of shares in a trading company out of a substantial shareholding and the conditions are satisfied. It should be noted that the sale must be *out of* a substantial shareholding as opposed to a sale *of* a substantial shareholding; it is not the percentage of shares sold that is relevant but rather the percentage holding prior to the sale.

The SSE exempts any gain arising on the sale of shares as well as denying relief for any loss. Consequently, it is an important exemption and its availability must be considered before chargeable gains or allowable losses are calculated.

For the exemption to be available:

- the vendor company must be a trading company or a member of a trading group, and
- the vendor company must have owned at least 10% of the company whose shares are being sold for a continuous period of 12 months in the two years prior to the sale. This qualifying 12-month period can include the time when the assets owned by the company being sold were used within a trade carried on by the group before being transferred to the company being sold. This extension to the qualifying period enables the SSE to apply where a trade is transferred to a new company (ie a company that has not been owned for 12 months) within a group prior to that company being sold to a third party.

Illustration

AF Ltd owns the whole of the ordinary share capital of JW Ltd. AF Ltd and JW Ltd are trading companies such that if AF Ltd were to sell the shares in JW Ltd the SSE would apply. However, AF Ltd has not been able to find a buyer for JW Ltd (this may be due to the possibility of there being contingent liabilities in JW Ltd). Consequently, the trade and assets of JW Ltd are to be transferred to a newly formed subsidiary, PN Ltd, and a buyer will then be found for the shares in PN Ltd.

The transfer of the assets to PN Ltd will take place at no gain, no loss because the two companies are in a capital gains group. However, degrouping charges (see below) will arise on the sale of PN Ltd as it will leave the group within six years of the no gain, no loss transfers. The degrouping charges will be added to the consideration received by AF Ltd on the sale of the shares in PN Ltd.

Although AF Ltd will not have owned PN Ltd for the requisite 12-month period, the SSE will be available on the sale of PN Ltd because the assets owned by PN Ltd will have been used within a trade carried on by the group.

Degrouping charges

If a company, MT Ltd, is to be purchased from QR Ltd, a member of a capital gains group, a review should be carried out in order to identify all no gain, no loss transfers to MT Ltd within the six years prior to the purchase. Any such transfers will give rise to degrouping charges if MT Ltd still owns the asset(s) transferred. The rules relating to degrouping charges were changed by Finance Act 2011.

Under the new rules, a degrouping charge is calculated by treating MT Ltd as having sold the asset for its market value as at the time of the no gain, no loss transfer. A chargeable gain (reduced by indexation allowance up to the date of the no gain, no loss transfer) or allowable loss is calculated in the normal way. This gain is then added to (or if a loss, deducted from) the consideration

received by QR Ltd in respect of the company that has left the group (MT Ltd). This will have the effect of increasing the chargeable gain realised by QR Ltd on the sale of MT Ltd (or reducing it if the asset concerned has fallen in value).

It should be recognised that the change to the consideration received by QR Ltd will often be irrelevant due to the availability of the SSE. Where the SSE is available the whole of the chargeable gain on the sale of MT Ltd, including the element relating to the degrouping charge, will be exempt. Similarly, relief will be denied for the whole of any loss.

Where the SSE is not available, a potential degrouping charge can be avoided by MT Ltd selling the asset concerned to a fellow group company before it leaves the group. It may then be necessary for MT Ltd to rent the asset if it is needed by its business. An alternative method of avoiding the charge is for MT Ltd and the company which made the no gain, no loss transfer to be sold as a self-contained capital gains group.

Illustration
QR Ltd owns 100% of the ordinary share capital of a number of subsidiary companies such that the companies are all members of a capital gains group. The companies prepare accounts to 31 March.

QR Ltd sold MT Ltd, one of its subsidiaries, for £280,000 on 1 September 2012. MT Ltd owns an asset that it acquired from another company within the group as a result of a no gain, no loss transfer within the six years prior to 1 September 2012.

The degrouping charge arising as a result of MT Ltd leaving the group was £75,000. This is added to the consideration received by QR Ltd for the sale of MT Ltd. The effect of this change is to increase QR Ltd's gain on the sale of MT Ltd by £75,000. However, if the substantial shareholding exemption is available in respect of the sale of MT Ltd, the whole of the gain on the sale will be exempt.

The election to transfer a chargeable gain or allowable loss to another group company
This election is a tax planning opportunity and something that you need to watch out for in exam questions. It enables the whole or part of a chargeable gain or allowable loss to be transferred from one group company to another. The availability of this election means that it does not matter which company in the group sells a particular asset. The gain arising, or any part of it, can be transferred to another company, to take advantage of that company's capital losses or lower rate of corporation tax. Similarly, the whole or part of any allowable loss can be transferred to another group company if desired.

When minimising the corporation tax liability of a group of companies, you must recognise that any capital gains or allowable losses can be transferred in whole or in part to any of the group companies, in addition to dealing with group relief. When transferring a capital gain, your thinking should be the opposite of group relief such that the gain should be transferred to the company paying tax at the lowest rate. Take care, however, as the capital gain will increase the company's profits and may, therefore, change its tax rate.

Pre-entry capital losses

In addition to the possibility of degrouping charges, you may need to point out to the purchasers of a company that restrictions apply to the use of its pre-entry capital losses. Pre-entry capital losses are the capital losses that the target company is carrying forward at the time it is acquired.

Pre-entry capital losses can only be used against gains arising on:

- assets sold by the target company before it is acquired; or
- assets owned by the target company at the time of acquisition; or
- assets subsequently purchased by the target company, from non-group companies, for use in its trade.

The effect of this rule is that the group of companies acquiring the target company cannot use the company's capital losses to relieve gains on group assets.

CONCLUSION

Where a question involves a capital gains group you should be able to anticipate the sort of additional information that may be given.

- Where a group company has made a capital gain, evaluate any possible advantage of transferring it to another group company.
- Where a group company is to be sold consider the availability of the SSE.
- If the SSE is not available, and there has been an earlier no gain, no loss transfer, look for ways to avoid any degrouping charge.
- On the purchase of a company, watch out for pre-entry capital losses.

Written by a member of the Paper P6 examining team

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SOLUTIONS TO QUESTIONS

The answers to the questions on the Q Ltd group of companies are:

1. Q Ltd's holding in G Ltd needs to be at least 75% for the two companies to be in a capital gains group. However, for all of the companies to be in a single such group, Q Ltd's indirect interest in I Ltd needs to be more than 50%. Accordingly, Q Ltd needs to increase its holding in G Ltd to more than 83.4%. Its indirect interest in I Ltd will then be more than 50% (83.4% x 80% x 75% = 50%).

2. M Ltd would not be in a capital gains group with Q Ltd, J Ltd, K Ltd and L Ltd, because the effective interest of Q Ltd in M Ltd would be 48.96% (80% x 80% x 90% x 85%), which is less than 50%. M Ltd would not be in a capital gains group with L Ltd because L Ltd is in a group with Q Ltd, J Ltd and K Ltd and cannot, therefore, be the principal member of its own group.