

# CORPORATION

## PART 2: RELEVANT TO ACCA QUALIFICATION PAPER P6 (UK)

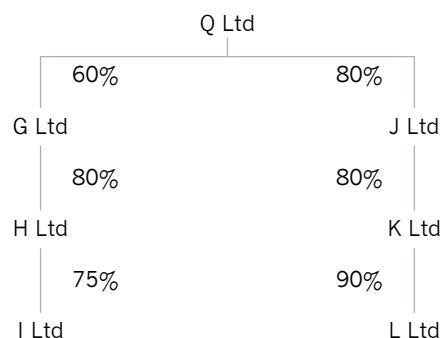
**This article is based on tax legislation as it applies to the tax year 2008-09 (Finance Act 2008), and is relevant for candidates sitting Paper P6 (UK) exam in June or December 2009. part 1 of this article appeared in the march 2009 issue of *Student Accountant*, and dealt with group relief.**

Students sitting Paper P6 (UK) in 2010 will be examined on the Finance Act 2009, which is the legislation as it relates to the tax year 2009-10. Accordingly, this article is not relevant to you; you should instead refer to the Finance Act 2009 version which will be published on the ACCA website in 2010.

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.

FIGURE 1: STRUCTURE OF THE Q LTD GROUP OF COMPANIES



### 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** on **page 75**.

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 treat a disposal by a group company as if it has been made by another company in the group
- ▣ 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:

# TAX: GROUPS

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 VITALLY IMPORTANT.

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 answers 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 branch 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 effectively 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.

TABLE 1: GROUP RELIEF AND CAPITAL GAINS GROUPS (RE FIG. 1)

	Group relief group	Capital gains group
The groups	<p>There are five separate group relief groups:</p> <ul style="list-style-type: none"> <li>▣ G Ltd and H Ltd</li> <li>▣ H Ltd and I Ltd</li> <li>▣ Q Ltd and J Ltd</li> <li>▣ J Ltd and K Ltd</li> <li>▣ K Ltd and L Ltd.</li> </ul>	<ul style="list-style-type: none"> <li>▣ Q Ltd, J Ltd, K Ltd and L Ltd form a capital gains group</li> <li>▣ G Ltd, H Ltd and I Ltd form a separate capital gains group</li> </ul>
Rationale	<ul style="list-style-type: none"> <li>▣ 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.</li> </ul>	<ul style="list-style-type: none"> <li>▣ The effective interest of a principal company in a non-directly held subsidiary needs only to be more than 50%</li> <li>▣ Q Ltd is not in a group with G Ltd because it does not have a direct 75% interest in G Ltd.</li> </ul>

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%.

#### Degrouping charges

If a company (say, MT Ltd) is to be purchased from 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 previous six years. Any such transfers will give rise to capital gains (or allowable losses), known as degrouping charges, if MT Ltd still owns the asset(s) transferred. Each such gain or loss is calculated by treating MT Ltd as if it has sold the asset for its market value as at the time of the no gain, no loss transfer. The gain or loss is treated as arising on the first day of the accounting period in which MT Ltd leaves the group.

Any degrouping charge arising on the acquisition of MT Ltd can be transferred to a continuing member of its original capital gains group. This may be advantageous if there are capital losses available in that company with which to relieve a degrouping capital gain or if the degrouping charge gives rise to an allowable loss which the continuing member is able to use.

Degrouping charges can be relieved via rollover relief provided the asset concerned is a qualifying business asset. An amount equal to the market value of the asset at the time of the no gain, no loss transfer would need to be invested in qualifying business assets for the whole of the gain to be relieved. The assets can be purchased by MT Ltd, the company leaving the group, or by another company in the group it is joining. Alternatively, if the degrouping charge is transferred to a continuing member of MT Ltd's original capital gains group, that company can purchase qualifying business assets and claim group relief.

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.

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.

#### The election to treat a disposal as having been made by 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 gain or 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 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.

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.

#### 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
- ▣ a proportion of capital losses made in the future on assets owned by the target company at the time the target company was acquired.

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

- ▣ assets sold by Target Ltd before it is acquired
- ▣ assets owned by the target company at the time of acquisition
- ▣ 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, expect there to have been an earlier no gain, no loss transfer and/or pre-entry capital losses. If a degrouping charge will arise on the sale (watch out for the six-year period), look for ways to avoid or relieve the charge.

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#### ANSWERS 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 83.33%. Its indirect interest in I Ltd will then be more than 50% ( $83.33\% \times 80\% \times 75\% = 50\%$ ).
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% ( $80\% \times 80\% \times 90\% \times 85\%$ ), 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.