Change Business Structure

Incorporation

- Change from unincorporated business (sole trader/partnership) to incorporated (company)
- Individual(s) transfers assets to company in exchange for shares in company
    1. Trade ceases for unincorporated business
        - Final trading profit/loss calculated for IT and NI
        - CA: BA or BC/succession election to transfer at TWDV as connected person
        - Inventory: trading profit/election to transfer at cost
        - Overlap profits deducted from profits
        - Unincorporated loss options:
            - Consider terminal loss relief or carry back claim
            - Consider loss c/f against future income from company
    2. Assets transferred to company
        - CGT on L&B, P&M, IFAs (including GW)
        - Gains automatically deferred under IR if:
            - All assets (except cash) transferred
            - Business is a going concern
            - Any cash received is taxable now
            - Can retain L&B to avoid SDLT and future gains in company
                - IR not available as not all assets transferred but can claim GR on other assets
            - Consider not claiming deferral relief if BADR won't apply on future share sale
            - Property business: IR applies if spends 20 hours per week on business
        - No BADR on disposal of GW to a close company if individual owns 5% of shares
        - VAT: TOGC if GW is transferred so no VAT charged on L&B/Inventory
            - Company must OTT buildings which are new (<3yrs) or OTT
            - Company continues with CGS adjustments
        - SDLT: L&B

          Property business:
            - Use average price or non-residential rates if ≥6 properties transferred
            - No SDLT if spouse/parent and child partnership incorporated
    3. Company starts trading
        - New AP for CT
        - CA claimed on MV if no succession election
        - Amortisation on IFAs deductible (except GW)

CGT

- Consider if exempt / not a chargeable asset
- Calculate gain
    - Base cost reduced by previously deferred gains – ROR, GR, IR, SFS (shares)
    - Gain increased by deferred/held over gains – HOR, EIS, Takeover (QCB)
- Identify reliefs
    - If the tax payable on the future disposal will be at the same rate as it would be taxed at now without the deferral relief, then claim the deferral relief as it has a cash flow benefit
    - If a tax rate reduction relief is available now but will not be available on the future disposal then it is better to not claim the deferral relief and pay tax on the gain now at a reduced rate
    - A tax rate reduction may be available now but not in the future if BADR/IVR conditions are met now but won't be met in the future
    - If a tax exemption is available now then it is better to not claim the deferral relief

CGT / IHT Interaction

<table>
<tr><th></th><th colspan="2">CGT</th><th colspan="4">IHT</th></tr>
<tr><td>Life Transfer</td><td>Exempt
<u>Asset</u>
Cash
Cars
ISA shares
QCB
Chattels

<u>Transferee</u>
Spouse
Charity

Annual Exemption (AE)</td><td>Reliefs
<u>Tax Deferral</u>
ROR - trading asset disposal and reinvestment in trading asset
GR - trading asset/shares disposal
GR - any asset disposal if LT IHT
EIS - any asset disposal and reinvestment in EIS shares

Disposal of asset could cause past gains previously deferred under the following to now become chargeable: ROR, GR, IR, EIS, gains on shares deferred following takeover (SFS)

<u>Tax Rate Reduction</u>
BADR - trading assets/shares disposal
IVR - Shares disposal

<u>Tax Exemption</u>
PRR - residential property disposal
SEIS - any asset disposal and reinvestment in SEIS shares</td><td>Exempt
<u>Asset</u>
N/A

<u>Transferee</u>
Spouse
Charity
Political

Annual/ Marriage Exemption (AE/ME)

Payments made from income</td><td>Reliefs

BPR - business assets/shares</td><td>PET

NRB

No LT

No DT if survives 7 years

DT 40% reduced by TR, FIV relief</td><td>CLT

NRB

LT 20/25%

No DT if survives 7 years

DT 40% reduced by TR, FIV relief, LT paid</td></tr>
<tr><td>Death Transfer</td><td colspan="2">Death is not a disposal for CGT so no tax to pay
Recipient's base cost is uplifted to value at death
Death has optimal outcome for CGT</td><td>Exempt
<u>Transferee</u>
Spouse
Charity
Political</td><td colspan="2">Reliefs
BPR - business assets/shares
RNRB - Residential property
QSR - IHT in last 5 years
Reduced rate (36%) - 10% to charity</td><td>Death Estate
NRB/RNRB

DT 40%</td></tr>
</table>

Reliefs

Tax Deferral Reliefs

- Tax deferral reliefs have a cash flow benefit but do not reduce tax payable as the gain is just deferred until a future disposal

Rollover Relief (ROR)

- Disposal of trading asset and replacement with new trading asset
    - Applies to disposal of:
        - L&B and P&M used in unincorporated trading business
        - Goodwill (GW)
- Replacement trading asset can be purchased one year before disposal/3 years after
- Any proceeds not reinvested are taxable now
- Gain on the old asset reduces base cost of the new asset
- When new asset is sold, gain will be higher as the base cost is lower
- Holdover Relief (HOR) if new asset has UEL ≤60 years; gain held over for maximum of 10 years

Gift Relief for Business Assets (GR)

- Gift of business assets or shares
    - Applies to disposal of:
        - Trading assets used in unincorporated trading business (L&B, P&M, Goodwill)
        - Shares in donor's trading company (5% of shares and voting rights)
        - Shares (unquoted) in a trading company
- Treat company as non-trading if >20% of turnover/assets/staff relate to non-trading
- Gift amount reduces the gain chargeable now and the base cost of the assets/shares
- When donee sells asset/shares, gain will be higher as the base cost is lower
- Restriction when shares are transferred to exclude non-trading/investment assets
    - GR: Chargeable trading assets / Total chargeable assets

Gift Relief when IHT due

- Special type of GR when there is a lifetime IHT charge on asset (CLT)
    - Applies to disposal of:
        - All assets where there is a lifetime IHT charge
- Gift amount reduces the gain chargeable now and the base cost of the assets/shares
- Still applies when IHT payable is nil due to AE, NRB or BPR

Incorporation Relief (IR)

- Unincorporated business transferring assets to company
    - Applies to disposal of:
        - Sole trader/Partners transferring assets to company in exchange for shares
            - Going concern
            - All assets transferred (except cash)
- Gains on old assets reduce base cost of the shares
- When shares are sold, gain will be higher as the base cost is lower

Chargeable Lifetime Transfer (CLT)

- Discretionary trust
- IIP trust

CLT			
Lifetime			
Value of transfer		X	Fall in value of transferor estate
Reliefs		(X)	APR/BPR
AE		(X)	AE b/f if not used in PY
Chargeable transfer		X	
NRB	£325k		
Gross Chargeable Transfers (GCT) made in 7 years before gift	(x)		GCT: transfer value AND IHT paid by transferor (LT IHT on CLT) Chargeable transfers only - PETs not chargeable until death
NRB available		(X)	
		X	
IHT@20/25%		X	25% if transferor pays - this increases the GCT
GCT		**X**	Transferor has given asset AND paid the IHT
On Death (dies within 7 years of gift)			
GCT		X	Above
BPR withdrawn		X	BPR withdrawn if transferee not using asset (or replacement) for business/agricultural use
Reliefs		(X)	Fall in value of asset since transfer
Chargeable transfer		X	
NRB	£325k		Higher if spouse died without using their NRB
GCT made in 7 years before gift	(x)		GCT: transfer value AND IHT paid by transferor PETs now chargeable as transferor died
NRB available		(X)	
		X	
IHT @ 40%		**X**	
Taper relief		(X)	Survived 3-7 years since gift
Lifetime tax (LT) paid		(X)	Above
IHT payable		**X**	

Family Investment Company (FIC)

- Close company with shares held by family members
- Company invests in assets which produce non-trading (passive) income e.g. property, shares
- Parent controls company with voting shares and by being appointed as director
- Child entitled to dividends and capital growth with non-voting shares
- Like a trust, this enables child to benefit from income generated whilst ensuring capital wealth is preserved and not wasted

Setting up FIC

- Parent subscribes to new shares
  - Stamp duty: newly issued shares exempt
- Parent gifts cash to child so child can subscribe to new shares
  - CGT: cash exempt
  - IHT: PET
  - Stamp duty: newly issued shares exempt
- Parent gifts existing shares to child
  - CGT: gain with proceeds at MV because connected (no reliefs as non-trading company)
  - IHT: PET (no BPR as non-trading company)
  - Stamp duty: gifts exempt
- Parent transfers assets (property, shares) to company
  - CGT: gain with proceeds at MV because connected; consider CGT reliefs (above)
  - IHT: no IHT on transfer to company
  - Stamp duty: 0.5% on shares; up to 15% on property
  - VAT: commercial property if new (<3yrs) or OTT

Operation of FIC

- Company owns assets (property, shares, bonds/loans) and earns rent, dividends, interest
- Company may also sell assets to generate cash
- Company pays CT on income and gains
  - Rent: Property income
  - Dividends: exempt
  - Interest receivable: NTLR
  - Gains on disposal of assets: Chargeable gain (consider SSE on share disposals)
- Interest payable on loans taken by company to acquire assets deductible as NTLR
- CT rate 25% on all profits from April 2023 as close investment company
- Profits extracted to provide income to shareholders/directors
  - Dividends: IT, no NI
  - Salary: IT and NI
  - Benefits: IT or exempt
  - Loans: 33.75% CT charge as close company
- Income paid to child under 18 is taxed on parent

Exit from FIC

- Parent transfers shares to child in life
  - CGT: gain with proceeds at MV because connected (no reliefs as non-trading company)
  - IHT: PET (no BPR as non-trading company)
  - Stamp duty: gifts exempt

- Parent transfers shares to child on death
  - CGT: death not a disposal; base cost uplift
  - IHT: NRB; 40%; no BPR as non-trading company
  - Stamp duty: inheritance exempt

Comparison to owning assets personally or in a trust

- Advantages: CT rate lower than IT rates; dividends exempt; interest payable deductible; less IHT compared with a trust
- Disadvantages: CT rate higher than CGT rate; double layer of taxation if income paid to shareholders/directors is taxable; company admin; potential for anti-avoidance legislation

CORPORATION TAX

AREA	TOPIC	CLASS	QUESTIONS	ICAEW Workbook
UK	R&D	CT: Advanced Topics	D16 Q1 (Q26.1) S17 Q3 (Q36.1 – Issue 1) S19 Q1 (Q48.1)	Ch9.2
	IFA	CT: Advanced Topics	D16 Q1 (Q26.1) S17 Q3 (Q36.1 – Issue 3)	Ch9.3
	Losses and Groups	[redacted]	[redacted]	[redacted]
	Close Companies	[redacted]	[redacted]	[redacted]
INTERNATIONAL	Structure (PE v Sub)	[redacted]	[redacted]	[redacted]
	PE Incorporation	[redacted]	[redacted]	[redacted]
	Migration	[redacted]	[redacted]	[redacted]
	Anti-Avoidance	[redacted]	[redacted]	[redacted]

Model Answer: December 2020

This answer demonstrates what you could realistically produce within the time limit under exam conditions. The ICAEW answers are too detailed and are not what students are expected to produce.

The points marked in red are hard. You do not need to get these points to pass the question. In fact, you do not need these points to get full marks!

You can watch Kieran answer a full BPT exam question here.

Q1.1

NOX

A company is Resident (R) in the UK for tax purposes if it is incorporated in the UK or managed and controlled (M&C) in the UK.

Nox is incorporated overseas and board of directors meet overseas so appears to be NR.

NR companies are taxed on trading income they earn in the UK from a UK PE.

Nox has a UK PE so PE profits subject to UK tax at 19%.

As profits are also taxed overseas, DTR available at 10% (lower than UK rate).

L appears to be a large group so transfer pricing rules apply. Therefore, UK profits will be adjusted if transactions are not at arm's length.

The revenue earned by the UK is below MV rate so profits in UK are understated.

TP adjustment to increase UK profits:

	Current	MV	Adjustment	19%
Revenue	5000	15000	10000	1900
Per unit	1	3		

There is likely to be an adjustment in respect of previous years.

HMRC should be notified of the errors in the tax returns when group is acquired.

MELANGE

L is UK R for tax purposes because incorporated in UK. Therefore, taxed in UK on UK and overseas profits/gains.

The PE was taxable in UK because it is part of L.

When PE incorporated, trade of PE ceases (BA/BC, final trading profit/loss).

Assets disposed of at MV to new NR company (M is NR because not incorporated in UK and doesn't appear to be managed from UK – need to confirm).