Time running out

Steve Kesby reminds small businesses operating through companies that disincorporation relief is due to end in March 2018.

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TEN SECOND SUMMARY

1. **The five-year period for which disincorporation relief applies will end on 31 March 2018.**
2. **The corporate business must be transferred as a going concern and all assets, except for cash, must be transferred.**
3. **With its demise imminent, a review is merited to identify whether any clients might benefit from disincorporation relief.**

In recent years, it has become somewhat less advantageous for small businesses to operate through the medium of a company. However, once a business is incorporated several tax charges arise if the business is transferred out of the company to its individual shareholders.

Disincorporation relief was introduced by Finance Act 2013, to mitigate some of these tax charges. It was originally brought in for a five-year period beginning with transfers on or after 1 April 2013. It will, therefore, cease to apply for transfers after 31 March 2018, but the Chartered Institute of Taxation (CIOT) has put forward a case to the Treasury for its retention and modification. These few months to March 2018 are therefore a sensible juncture for a review to see whether it might be useful to any clients.

The relief is available when a company transfers its business to some or all of its shareholders and various qualifying criteria are met. If it applies, it prevents the company having chargeable gains or taxable credits under the corporate intangibles regime on specific "qualifying assets".

Qualifying criteria and qualifying assets

Qualifying assets, for the purposes of the relief, means goodwill (whether within the corporate intangibles or chargeable gains regimes) and interests in land other than that held as trading stock.

For the relief to be available, it must be claimed and the total value of the company's qualifying assets immediately before transfer must not exceed £100,000. This low threshold may explain why the CIOT's recent submission on the relief, noted that there had been fewer than 50 claimants so far.

Further, the business must be transferred as a going concern and all its assets must be transferred, with cash being a permitted exception.

It is also a requirement that all shareholders to whom the business is transferred must be individuals, and each must have held their shares in the company for at least 12 months at the date of transfer.

In relation to this final point, the relief will apply if the business is transferred to a partnership comprising some or all of the company's eligible shareholders, but not if the transfer is to a limited liability partnership (which is strictly a body corporate) of which they are members. A transfer

to a partnership followed by a transfer to a limited liability partnership would, however, secure the relief as long as the partnership carries on the business between the two transfers, so that the going concern condition is met.

Claim requirements

As noted above, incorporation relief must be claimed within two years from the date of transfer. The claim must be made jointly by the company and all the individual shareholders to whom the business is transferred. The claim is irrevocable once made.

The corporate intangibles regime

Goodwill will fall within the corporate intangibles regime if it was acquired or created on or after 1 April 2002. If goodwill was acquired by a company on or after that date, but the business concerned was carried on by a related party before then, it will fall outside the intangibles regime, and the chargeable gains regime (considered below) will apply.

Without disincorporation relief, if goodwill within the intangibles regime is transferred to a company's shareholders, the related party rules dictate that this would be deemed to be transferred for a market value consideration. However, if the relief applies, the transfer is deemed to be made at a consideration that will not give rise to a taxable credit for the company. There are essentially two possibilities.

The first is that the goodwill is not included in the company's balance sheet (as would be the case for goodwill created by the company), where the deemed consideration is then nil.

For capital gains tax purposes, the individual shareholders then take the goodwill over with no base cost.

Alternatively, if the goodwill is included in the company's balance sheet, the deemed consideration is the lower of its tax written down value and its market value; the tax written down value usually being its cost, less any tax deductible debits that may have been given in the past.

In this respect, remember that the amounts of any deductible debits (other than on realisation of an asset) under the intangibles regime are restricted in relation to transfers on or after 3 December 2014 and are eliminated in relation to transfers on or after 8 July 2015.

For capital gains tax purposes, the individual shareholders then acquire the goodwill with a base cost equal to their proportion of this deemed consideration.

If this deemed consideration produces a realisation debit, some or all of it may be treated as a non-trade debit under the changes that apply in relation to goodwill originally acquired from related parties on or after 3 December 2015, and all goodwill acquisitions made on or after 8 July 2015.

These provisions do, however, ensure that a taxable credit does not arise on the transfer.

The chargeable gains regime

Interests in land and goodwill acquired or created – whether by the company or a related party – before 1 April 2002 fall within the chargeable gains regime. Again, there is a general rule that transfers of chargeable assets between connected parties are deemed to have been transferred for a market value consideration. Disincorporation relief then operates to override this general rule, and deem the assets to have been transferred for an amount that is the lower of the asset's market value and the company's base cost of it for chargeable gains purposes. The individuals take over their proportion of the asset with their share of this deemed transfer consideration.

Again, this prevents a chargeable gain from accruing to the company, but allows it to claim any loss that may have arisen (which it may or may not be able to use).

When the relief does not apply

The relief only eliminates chargeable gains or taxable credits under the intangibles regime in relation to qualifying assets. If there are chargeable assets other than goodwill and interests in land, any gains will be taxable on the company. Equally, if there are intangible assets other than goodwill within the intangibles regime, the company may have taxable credits.

For transfers of plant and machinery, trading stock or work in progress, there are provisions that can apply to prevent profits being realised, but nowhere is there any relief for the tax charges that might arise on the shareholders.

Where assets pass out of the company and there is no consideration or this falls short of market value for the assets, there is a distribution of the company's assets as a matter of company law.

As a result of the "anti-phoenixing" targeted anti-avoidance rule (TAAR) introduced in FA 2016, any such distribution, whether or not on a winding-up, will be taxable as dividend income, with one particular and very limited exception.

Only a distribution that is made in anticipation of the dissolution of a company, and where all such distributions do not exceed £25,000, will be taxable as a capital disposal, potentially attracting entrepreneurs' relief, such that it is taxed at only 10%.

Otherwise these distributions will be taxable at the individuals' marginal rates for dividend income, subject to the effect of the dividend nil-rate band.

Conclusions

With the effect of the new TAAR and the limited application of the disincorporation relief it is perhaps unsurprising that there have been a limited number of claimants. Nonetheless, with its demise potentially imminent a review is merited to identify whether any clients might benefit from its application.

Such a review will need to be completed in good time so that any transfers can be made before the window closes on 31 March 2018.

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Having qualified as a chartered accountant in audit roles, following a period focusing on personal taxation, Steve went on to specialise in corporate tax and owner-managed businesses, qualifying as a chartered tax adviser through the corporate tax route. Subsequent diversification of his experience also resulted in his qualifying with the Institute of Indirect Taxation.

Steve's current role concentrates on non-domiciles, non-residents and corporate reconstructions, but his diverse experience and skill set means he can advise on a wide range of tax matters. He is also a regular contributor to the Readers' Forum in *Taxation* magazine and to AccountingWeb.co.uk.
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