CHAPTER 22

GROUP CAPITAL GAINS

22.1 Definition

Companies are in the same capital gains group when one company owns at **least 75%** of the ordinary shares of another company or two companies are 75% owned by the same parent.

TCGA 1992, s. 170

This 75% definition is similar to the rules for group relief but, for group gains purposes, we **only need 75% of the ordinary shares** and not 75% of distributable profits nor 75% of assets on a winding-up.

The group gains regime also has slightly different rules for sub-subsidiaries.

For group gains, the direct relationship must be at least 75% but **the indirect relationship need only be above 50%.** We refer to this as the effective 51% subsidiary test.

TCGA 1992, s. 170(3)

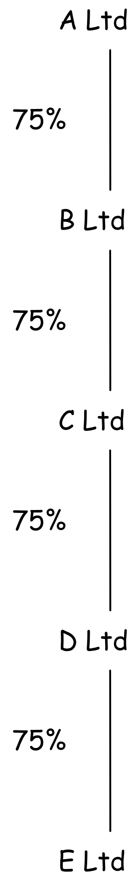
In addition, for group gains a company can only be a member of one group.

TCGA 1992, s. 170(6)

There is a summary of the different groups for corporation tax purposes with their definitions at the end of this chapter.

Illustration 1

Consider the following structure:



Group relief group:

For group loss relief we need a **75% direct and indirect relationship**.

Therefore, for group relief we can transfer losses between A and B, between B and C, between C and D and between D and E.

The indirect relationship between A and C is 56.25%. For group relief we need at least 75%; no losses can flow between A and C nor between A and any other companies further down the group.

Group gains group:

When considering a capital gains group we must look at the A group as A is the ultimate holding company. Thus we call A the principal company. A owns 56.25% of C and, consequently, C can be included in A's gains group.

However, A only owns 42% of D (75% of 56.25%), and therefore as this is below 50%, D is not part of A's group. Consequently, the A capital gains group comprises companies A, B and C.

We cannot link C and D for the group gains purposes - the reason for this is that a company which is a 75 % subsidiary of another company cannot be a principal company unless it fails the effective subsidiary test. In other words a company cannot be a member of more than one group for group gains purposes.

As C is a member of A's gains group, it cannot form a sub-group with D. This rule does not apply to group relief so for group relief we can link C and D, but for group gains we cannot.

However, D can be a principal company and form its own group and, consequently, we can link D and E together for group gains purposes as D becomes a new holding company. So, for group gains, we have two groups, the A group comprising A, B and C, and the D group comprising D and E.

Transfers of assets:

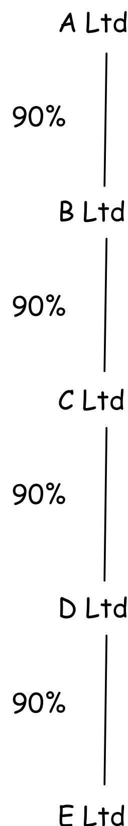
C and D are clearly connected companies and consequently any transfers between these companies will be at market value.

Transfers of assets within the **same capital gains group** however will all take place at **no gain no loss** - we shall study this in more detail shortly.

TCGA 1992, s. 171

Example 1

Consider the following structure:



Identify which companies are in A's group relief group and capital gains group.

22.2 Intra group transfers of assets

TCGA 1992, s.171

Transfers between **members** of the **same group** are treated as **no gain no loss transfers**. This rule applies automatically and is compulsory. This is the same rule that applies to transfers of assets between a married couple.

The no gain no loss rule will **not** apply where a disposal arises as a result of the exercise of an option that was granted before the companies became members of the same group.

TCGA 1992, s. 171(2)(da)

The rules apply where:

a) the transferring company is UK resident at the time of the disposal or the asset is a chargeable asset in relation to the company immediately before that time, and

b) the transferee company is either UK resident at the time of the disposal or the asset is a chargeable asset in relation to that company immediately after that time.

Illustration 2

Beckham Limited owns 100% of Posh Limited. In September 1992 Beckham Limited purchased a property at a cost of £500,000. In January 2011, Beckham Limited decided to transfer this property to Posh Limited. The transfer will take place at no gain no loss.

We have a cost of £500,000, indexation of say £250,000 therefore, our proceeds are deemed to be £750,000 in order to give us no gain no loss.

	£
Proceeds	750,000
Cost	(500,000)
Indexation at, say 50%	(250,000)
	nil

In other words the proceeds are cost plus indexation to the date of transfer.

Consequently, Posh Limited will have a base cost of this particular property of £750,000 which it will index in a future disposal calculation from January 2011, the date of the intra-group transfer.

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Example 2

Thompson Ltd has one wholly owned subsidiary, Murphy Ltd. Murphy bought a property for £180,000 in July 1988. In December 2001 it transferred the property to Thompson Ltd when its market value was £250,000.

Thompson Ltd sold the property in August 2011 for £380,000.

You are required to calculate the gain chargeable on Thompson Ltd in its accounts for the 12 months to 31 December 2011.

Assume (for illustration purposes) the following indexed rises:

July 1988 – December 2000:	0.641
December 2000 -August 2011:	0.186

22.3 Re-allocation of gains and losses

TCGA 1992, s.171A

An election under s171A TCGA 1992 allows a **gain or a loss** arising to one group company to be **transferred to another group company**.

This is to allow the group to **utilise capital losses** and also to ensure **gains are taxed at the lowest marginal rate** possible.

Illustration 3

Bush Limited owns 100% of Blair Limited. They have income in the year ended 31 March 2011 of £500,000 and £75,000 respectively. Blair Limited has capital losses brought forward of £90,000.

On 1 October 2010 Bush Limited sold a property and realised a chargeable gain of £150,000. What we must do is ascertain in which company it would be better for the gain to arise.

As there are two companies in the group, the corporation tax lower and upper limits must be divided by two giving us £150,000 and £750,000 respectively. The marginal rates of tax are 21% below £150,000, 29.75% between the limits and 28% above £750,000.

As Bush has other profits of £500,000, if we were to add the gain to Bush's profits, the gain would be taxed in full at the marginal 29.75% rate of tax. The extra tax would be:

£150,000 x 29.75% = £44,625

However, if we were to make an election under s171A TCGA 1992 to transfer the gain on the property from Bush Limited to Blair Limited (by electing on the CT600), we might find we get a better result.

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Blair Limited has other income of £75,000. We would utilise Blair Limited's capital losses brought forward of £90,000 reducing the chargeable gain to £60,000. The gain will all be taxed at 21% so the extra tax this time would be:

£(150,000 – 90,000) x 21% = £12,600

So making the election to treat the gain as accruing to Blair Limited will save the group corporation tax of:

£44,625 - £12,600 = £32,025

Clearly this would be worthwhile.

22.4 Making the election

TCGA 1992, s.171A

The election to treat a gain or loss (or any part of it) as accruing to a fellow group company can only be made if the no gain no loss transfer rule would apply between the two companies who make the election.

It has to be a **joint election made in writing within two years** of the end of the accounting period of the company who accrues the gain or loss.

TCGA 1992, s. 171A(5)

Any payments made between the companies in relation to the notional transfer will be ignored to the extent they do not exceed the chargeable gain or allowable loss accruing.

TCGA 1992, s. 171B(6)

The above election only applies to **gains or losses** accruing **on or after 21 July 2009**. For disposals prior to this date an election under s171A resulted in a **notional transfer** within the group of an **asset, or part of it, prior to it being sold**.

In most circumstances this had the same effect as the election to transfer the gain or loss as described above. However, it meant that relief was only available in respect of **actual** disposals to third parties. For example, it was not possible to obtain relief for a loss arising on a negligible value claim.

Finance Act 2009 amended the legislation to make it easier for groups to match gains and losses.

Example 3

Calf Limited is a wholly owned subsidiary of Bull Limited. Bull Limited does not have any other subsidiaries. During the year ended 31 March 2011, the predicted profits of each company are £100,000 and £700,000 respectively. Calf Limited has capital losses brought forward of £30,000 and in February 2011 Bull Limited sold a property realising a chargeable gain of £100,000.

Assuming that they are going to make the most beneficial elections, calculate the minimum corporation tax payable on this gain.

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22.5 Group wide rollover relief

TCGA 1992, s. 175
TCGA 1992, s. 152

A **capital gains group** is **treated as one unit for rollover relief purposes.**

Assume that A and B are part of the same capital gains group and that A has sold an asset for £900,000 which has realised a chargeable gain of £350,000.

Remembering the normal rules of rollover, provided that **within one year prior to the sale and three years after,** A reinvests all of the £900,000 proceeds, the capital gain can be rolled over and deducted from the base cost of a replacement asset.

Assume B invested £1 million into a new asset. This will enable the gain in A to be rolled over against the base cost of the asset purchased by B under the group wide rollover provisions. This gives a base cost of the replacement asset in B of £650,000.

The rules on group rollover apply to all companies so long as they are resident in the UK or carrying on a trade in the UK through a permanent establishment.

The rules apply where a company which is a member of a group disposes of an asset used in its trade at a time when it is a member of the group, another company acquires an asset at a time when it is a member of the same group and a joint claim is made by the companies. The claim must be made within 4 years (from 1 April 2010) of the end of the chargeable accounting period of the first disposal.

Thus there is no requirement for the companies to be members of the group at the same time. However the company making the disposal must be UK resident, or the asset must be chargeable at the time of the disposal and the company acquiring the asset must be UK resident, or the asset must be a chargeable UK asset at the time it is bought.

The disposal and acquisition of assets by non-trading companies in the group can qualify for rollover relief so long as they are used in the trade of other companies in the group.

Rollover relief cannot be claimed for the acquisition of assets from group companies where no gain no loss rules apply.

22.6 Transfers within a group: trading stock

TCGA 1992, s.173

Special rules apply where an asset held as capital is transferred to another member of a capital gains group which will hold the asset as stock and vice versa.

Where an asset held as **capital** is transferred by company A **to** company B in the same gains group who will hold the asset as **trading stock,** the **transfer will take place under the no gain/ no loss rules**. Once B receives the asset, it will be immediately **taken to trading stock at its market value.**

Illustration 4

Cap Ltd, a trading company, transfers a property to Hat Ltd, a property-dealing company. The companies are in the same gains group. Cap Ltd had bought the property many years ago for £550,000. The indexation factor up to the date of transfer is 0.225. The market value of the property at the time of the transfer was £740,000

Firstly, the property will go from Cap Ltd to Hat Ltd at no gain no loss. The deemed disposal proceeds for Cap Ltd will be:

	£
Cost	550,000
IA 0.225 x 550,000	123,750
	673,750

This will also be the base cost of the property for Hat Ltd.

The asset will then be taken to stock in Hat Ltd at its market value of £740,000 and so a gain will arise in Hat Ltd as follows:

	£
Deemed proceeds	740,000
Indexed cost	(673,750)
	66,250

If Hat Ltd now sells the property from stock at its market value there will be no trading profit.

Hat Ltd, a property-dealing company, has therefore ended up with a capital gain. The company normally has trade profits or losses from property sales.

Hat Ltd can make use of the election in s.161 TCGA 1992 - this election allows a trader who is appropriating a capital asset to stock to **elect for the asset to be taken to stock at its indexed cost.** The election has to be **made within two years** of the end of the accounting period in which the asset is taken to stock.

If Hat Ltd makes this election, at the time of the transfer from Cap Ltd the building will be taken to stock at a value of £673,750 and there will be no capital gain. On a future sale of the property at market value, a trade profit of £66,250 will arise.

This election will be especially useful where the property-dealing company has trading losses brought forward or the transferred asset is standing at a capital loss.

If an asset is transferred by a company that holds it as trading **stock, to** a company that will hold the asset as a **capital** asset, then the company that holds the asset as trading stock is treated as making a **disposal from trading stock** at market value prior to the transfer.

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Illustration 5

Paper Ltd and Tray Ltd are two companies in a gains group. Paper Ltd is a property dealing company, Tray Ltd is a trading company. Paper Ltd has a property which it bought for £370,000. The market value of the property is £400,000. It is to be transferred to Tray Ltd.

Paper Ltd will be treated as taking the property out of trading stock at its market value and so will make a trade profit of £400,000 - £370,000 = £30,000.

Tray Ltd will receive the property at its market value of £400,000. Indexation allowance will begin to run from the date the property is transferred.

22.7 Share for share exchanges

For the purposes of explaining the share for share rules, we will assume the substantial shareholding rules do not apply (see later chapter) to the shares in question.

The general rule is that where a person exchanges shares in one company for shares in another, that person can be treated as **not making any disposal** of the original shares or any acquisition of the new holding under the share reorganisation provisions of s.127 TCGA 1992. Instead the new holding is treated as if it was acquired when the original shares were acquired. The base cost for the old shares becomes the base cost of the new shares.

TCGA 1992, s.135

So when does s.127 apply? When can we use the **no disposal** "paper for paper" rules? The rules apply where there has been a **reorganisation** either under s.135 TCGA 1992 which applies when one company takes over another, or under s.136 where there has been a **reconstruction**.

These rules apply as a matter of fact and no clearance can be obtained in advance from HMRC. However, in addition to the reorganisation rules applying, the transactions must take place for **bona fide commercial reasons** and their main object must **not be the avoidance of a tax liability**.

This is given under s.137 TCGA 1992 and statutory clearance is available under s.138. In the clearance the company must state in full what transactions are taking place and HMRC will then confirm (or not as the case may be), that they consider the scheme is going ahead for bona fide commercial reasons and that the main object of that scheme is not the avoidance of tax.

So what is the interaction between the no disposal rule for share reorganisations in s.127 and the no gain/no loss rule for intra-group asset transfers in s.171?

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S.171(3) TCGA 1992 prevents the no gain/no loss disposal rule from applying in relation to any share exchange to which s.135 applies. This section was brought in following the decision in the *Woolcombers* case. Prior to *Woolcombers,* HMRC had held the view that the provisions relating to share exchanges meant that no disposal took place and thus s.171 was not in point as it required a disposal. This view was overturned in the *Woolcombers* and so s.171(3) was brought in to clarify the point.

If Company A is transferring shares in Company C to Company B in return for shares in Company B and all the companies are in the same group, Company A will be treated as having acquired the shares issued by Company B for the price paid for the shares in Company C. Company B will be treated as acquiring an asset from a connected party. Thus the base cost for Company B of the shares in Company C will be market value.

Illustration 6

Barcelona Ltd is the holding company of an investment group and owns 100% of Valencia Ltd which it bought five years ago at a total cost of £3 million. It also owns 100% of Cadiz Ltd.

Barcelona Ltd decided to transfer its shares in Valencia Ltd to Cadiz Ltd when their market value had fallen to £2.5million. This is done in return for **new shares** issued in Cadiz Ltd to Barcelona Ltd.

This will be treated as a **paper for paper transaction** in Barcelona Ltd as the company has exchanged its shares in Valencia Ltd for new shares in Cadiz Ltd. The paper for paper rules will apply and consequently the **base cost of its original holding in Valencia Ltd** will now transfer to the **new shares it owns in Cadiz Ltd**, this being £3million, which will be indexed from the time of the original acquisition five years ago.

However, the base cost of the Valencia Ltd shares in Cadiz Ltd will be the market value of that holding at the time of the transfer which is £2.5million. This is because the transfer between these two companies takes place at **market value** as both Valencia Ltd and Cadiz Ltd are connected parties. S.171 no gain no loss rules do not apply in this particular scenario but instead a disposal is triggered under the normal connected party rules.

This treatment ensures that we do not duplicate the latent loss on the Valencia Ltd shares. If we were to apply s.171 to the acquisition cost of the Valencia Ltd shares by Cadiz Ltd then the base cost would be £3m plus indexation, which could give rise to a loss on disposal when Cadiz Ltd sells Valencia Ltd and a loss on disposal when Barcelona Ltd sells Cadiz Ltd.

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Answer 1

Group relief group:

Clearly for group relief we can transfer losses between A and B and between B and C. A indirectly owns 81% of C (90% of 90%). Consequently, losses can also be transferred between A and C.

A indirectly owns 72.9% of D (90% of 81%). This is below 75% and consequently losses cannot flow between A and D.

Therefore the group relief group relevant to A includes companies **A, B and C.**

Group gains group:

For group gains A indirectly owns 81% of C, 72.9% of D and 65.61% of E (90% of 72.9%). So, going all the way down the chain, we find that A's indirect relationship in E is above 50% so consequently all of the companies are in A's gains group.

Therefore the group gains group relevant to A includes companies **A, B, C, D and E.**

Answer 2

Transfer from Murphy Ltd to Thompson Ltd in December 2000:

	£
Cost to Murphy Ltd	180,000
IA from July 1988 - December 2000	
0.641 x £180,000	115,380
Cost to Thompson Ltd	295,380

Disposal by Thompson Ltd in August 2011:

Proceeds	380,000
Less: Cost December 2000	(295,380)
	84,620
Less: IA Dec 2000 - August 2011	
0.186 x £295,380	(54,941)
Gain y/e 31.12.2011	**29,679**

Answer 3

The upper and lower limits are £750,000 and £150,000 respectively.

Bull Ltd has other income of £700,000.

If the gain was taxed in Bull Ltd it would increase corporation tax liability by:

£(50,000 x 29.75%) + £(50,000 x 28%) = £28,875

Calf Ltd has other income of £100,000.

If we elect to treat the gain as accruing in Calf Ltd, the position would be improved as Calf has some capacity in the 21% band and also has capital losses brought forward.

	£
Gain	100,000
Capital losses b/f	(30,000)
	70,000

The corporation tax liability would be:

(£50,000 x 21% + £20,000 x 29.75%) = **£16,450**

Making the election under s.171A TCGA 1992 has therefore saved tax of £12,425 for the group.