CHAPTER 23

GROUP GAINS – FURTHER ASPECTS

23.1 Companies leaving a group

Assets are transferred between group companies on a no gain no loss basis. However, **if** a **company leaves the group within 6 years of an intra-group transfer, still owning the asset, a gain** will be **assessed on the departing company** as though at the time of the original transfer the asset had been sold and repurchased by the departing company. This charge is known as **a degrouping charge** or an **exit charge.**

TCGA 1992, s. 179

The gain itself is taxed on the departing company in the chargeable accounting period of it leaving the group.

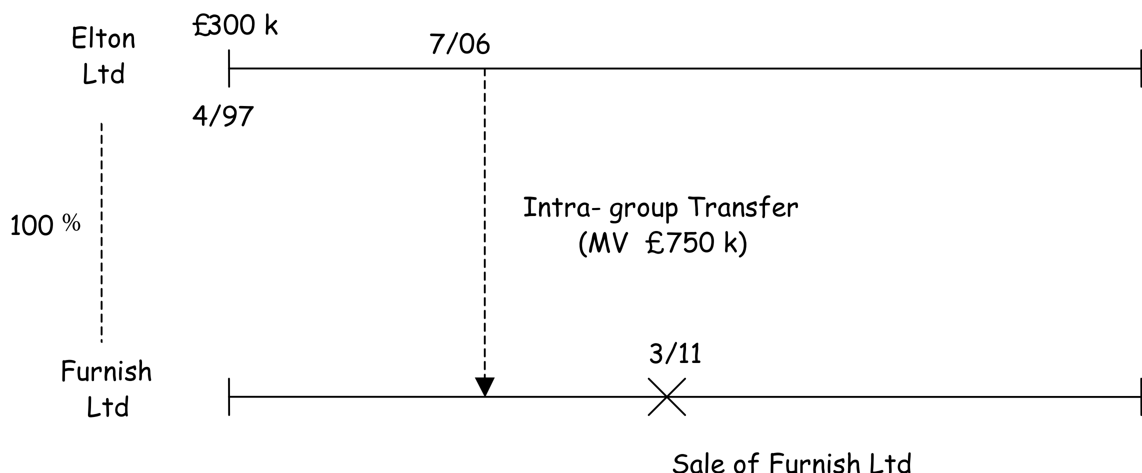
Strictly speaking, the resulting gain (or loss) is treated as arising on the later of:

TCGA 1992, s. 179(4)

(i) the first day of the accounting period in which the company left the group; or
(ii) the date of the intra-group asset transfer.

Illustration 1

Elton Ltd owns 100% of Furnish Ltd. In April 1997, Elton Ltd purchased a property for £300,000. In July 2006 Elton Ltd transferred the property to Furnish Ltd when it was worth £750,000. In March 2011, Elton Ltd sold its stake in Furnish Ltd.



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The sale of Furnish Ltd is within 6 years of the intra-group transfer and therefore the no gain/ no loss rule will not apply to the original s.171 transfer anymore. Instead it will be deemed that Furnish sold and reacquired the asset at the time of the intra group transfer. So, computing the gain:

	£
Proceeds = MV in July 2006	750,000
Cost	(300,000)
Indexation April 1997 to July 2006	
Assume 30%	(90,000)
Exit charge	**£360,000**

This gain will be charged on Furnish Limited in the chargeable accounting period when it leaves the group. For instance, if each company has a December year end, this will be in the year ended 31 December 2011 as the company left the group in March 2011.

Example 1

Cage Ltd owns 100% of Fish Ltd. In January 1993 Cage Ltd purchased a warehouse for £150,000 which it transferred to Fish Ltd in May 2005.

In January 2011 Cage Ltd sold all of its shares in Fish Ltd.

The value of the warehouse is as follows:

May 2005	£480,000
January 2011	£760,000

What is the gain arising and which company will be assessed on it?

Assume indexed rises as follows:

Jan 1993 to May 2005	35%
May 2003 to Jan 2011	30%

An **important exception** from the degrouping charge is where **associated companies leave a group at the same time**. The exception is that where two or more associated companies cease to be members of the group at the same time, the degrouping charge does not apply to the acquisition of an asset by one from another of those associated companies. For this purpose, the definition of `associated companies' is that by themselves, the two companies **would form a group of companies for gains purposes.** The companies have to be associated both before and after they cease to be members of a group.

TCGA 1992, s. 179(2)

TCGA 1992, s.179(10)

The wording of s.179(10) was considered in *Johnston Publishing (North) Ltd v Revenue and Customs Commissioners (2007).* It was decided that in order for this exception to apply, the companies must have been associated at the time of the transfer and not just at the time that they both leave the group.

23.2 Reallocation of the degrouping charge

All or part of a gain (or loss) arising as a result of the degrouping legislation can be **reallocated to one or more members of the group.**

TCGA 1992, s.179A

This effectively **parallels the reallocation rules** in s.171A TCGA 1992

Illustration 2

Gallagher Ltd, Heather Ltd and Ingram Ltd are all 100% subsidiaries of the same parent company. The group has a 30 June year end.

On 1 May 2010 Heather Ltd sold a freehold warehouse with an indexed base cost of £240,000 to Gallagher Ltd for a market value price of £400,000.

On 1 November 2010, Gallagher Ltd was sold.

As at 30 June 2010, Ingram Ltd had capital losses carried forward which totalled £175,000.

The capital gains position is as follows:

(i) The disposal by Heather Ltd to its fellow subsidiary on 1 May 2010 is a no gain no loss transaction under s.171 TCGA 1992.

(ii) However, when Gallagher Ltd leaves the group on 1 November 2010, this crystallises a s.179 TCGA 1992 charge in the sum of:

	£
Market value on 1 May 2010	400,000
Less: Indexed base cost	240,000
	£160,000

This gain accrues on the later of:

- 1 July 2010 (the start of the accounting period in which Gallagher Ltd left the group); or
- 1 May 2010 (the date of the intra-group asset transfer).

In this case, the gain is deemed to arise on Gallagher Ltd on **1 July 2010**. This falls in the accounting period to 30 June 2011.

(iii) By virtue of s.179A(3) TCGA 1992, Gallagher Ltd and Ingram Ltd can make a **joint election** under which the s.179 TCGA 1992 gain of £160,000 is deemed to accrue to Ingram Ltd for the year ended 30 June 2011. Given the level of Ingram Ltd's capital losses brought forward for this year, there will be no corporation tax charge on the gain.

The main conditions which must be satisfied in order for an election under s.179A TCGA 1992 to be valid are:

TCGA 1992, s.179A

(i) The company to which the degrouping gain is reallocated must be a member of the same gains group as the s.179 TCGA 1992 company **at the time when the gain is deemed to accrue** to the latter company. Thus, in Illustration 2, the gain of £160,000 accrues on 1 July 2010, on which date both Gallagher Ltd and Ingram Ltd were still members of the same group.

(ii) Where two or more elections are made (e.g. because more than two group companies are involved), one or more elections will not be valid if, taking into consideration any earlier elections in respect of the same gain or loss, they seek to reallocate more than the total amount of that gain

(iii) At the time when the gain is deemed to accrue, the company to which the degrouping gain is reallocated must either be UK-resident or else own assets which are within the scope of UK corporation tax on chargeable gains. In Illustration 2, it is assumed that Ingram Ltd is UK-resident.

(iv) The **time limit for making the election is two years** after the end of the degrouping company's accounting period in which the s.179 TCGA 1992 gain was deemed to accrue. In Illustration 2, the gain accrued on 1 July 2010. This date falls into the year ended 30 June 2011. Therefore, the time limit within which Gallagher Ltd and Ingram Ltd must make their joint election is 30 June 2013.

(v) Any payment made in connection with the reallocation of a gain under s.179A TCGA 1992 is disregarded for corporation tax purposes, provided that it does not exceed the amount of the reallocated gain.

23.3 Rollover relief and degrouping charges

It is possible to rollover a gain arising as a result of the degrouping rules.

Illustration 3

Several years ago, Best Ltd bought some business premises for £100,000. On 1 December 2006, Best Ltd transferred the property to Atkinson Ltd (a fellow group member) at a time when the market value was £400,000. It is assumed that the indexation factor was 0.250. On 1 June 2010, Atkinson Ltd left the group. The group's year end is 30 April.

On 1 July 2011, Atkinson Ltd acquired additional premises at a cost of £500,000.

When Atkinson Ltd left the group, a s.179 TCGA 1992 gain accrued:

		£	£
Market value on 1 December 2006			400,000
Less:	Cost	100,000	
	Indexation allowance:		
	£100,000 x 0.250	25,000	
			(125,000)
			£275,000

The gain of £275,000 can be rolled over against the cost of the additional premises which Atkinson Ltd bought for £500,000 on 1 July 2011.

In order for the relief to apply, the following conditions must be satisfied (these use Illustration 3 above as an example):

(i) Best Ltd must have been carrying on a trade at the time of the intra-group asset transfer.

(ii) The property which was transferred to Atkinson Ltd must have been used for the purposes of Best Ltd's trade.

(iii) An amount equal to the deemed sale consideration of the property must have been reinvested in one or more new assets by Atkinson Ltd in order for full rollover relief to be available.

(iv) The new asset must be taken into use for the purposes of Atkinson Ltd's trade.

(v) Both the old and the new assets must be within the classes set out in s.155 TCGA 1992.

(vi) Atkinson Ltd must make a claim for the relief.

Given that these conditions are satisfied, the normal rollover relief consequences follow, that is to say:

(i) Atkinson Ltd is treated as having disposed of the premises acquired from Best Ltd at such amount that neither a gain nor loss arises.

(ii) The acquisition cost of Atkinson Ltd's new premises is reduced from £500,000 to £225,000.

(iii) But the acquisition cost of the property which was subject to the s.179 TCGA 1992 charge in Atkinson Ltd's hands is **not reduced** and stays at £400,000 – otherwise there would be an element of double counting.

As expected, the period for reinvestment runs from **12 months before to three years after** the time when the s.179 TCGA 1992 charge accrues.

If appropriate, a partial rollover relief claim can be made where the full amount is not reinvested.

Note also that the special rules in s.153A TCGA 1992 have been modified to allow a company to make a provisional claim for relief in its CT600 for the year in which the s.179 TCGA 1992 gain accrues.

There have been changes to s.175 TCGA 1992 which applies rollover relief to capital gains groups. The overall effect of these changes is that, where (again using Illustration 3) Atkinson Ltd is a member of a group at the time when the s.179 TCGA 1992 charge arises and another member of the group reinvests an amount equal to the deemed sale consideration, that other company can make a claim for rollover relief.

23.4 Companies joining a group

Anti-avoidance rules prevent a company buying another company in order to use its capital losses.

TCGA 1992, Sch 7A

Illustration 4

A has recently purchased a 75% stake in B, a company which has capital losses brought forward of £50,000. A is about to sell an asset that will result in a gain of £120,000 and is looking for a way to shelter this gain.

A could transfer the gain to B, so that B is treated as having realised the £120,000 gain.

However, under the anti-avoidance rules, transferred gains cannot be sheltered by pre-entry capital losses brought forward as these capital losses arose prior to B joining A's group.

23.5 Use of pre-entry capital losses

Pre-entry losses can only be set against:

TCGA 1992, Sch 7A Para 7

(i) **Gains on assets held at the time** the company joined the group; or

(ii) **Gains on assets bought after joining** the group from a non-group company, **which are used in a trade** carried on by the company **at the time it joined that group.**

In other words, pre-entry losses can only be set against assets the company owns at the time of joining or assets it would have purchased in any case.

Pre-entry capital losses can be divided into two groups:

(i) **Realised pre-entry losses**, which are losses on assets which have already been sold by the time the company joins the group, or

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(ii) **Unrealised pre-entry losses**, which arise on assets still held at the time of joining the group which are currently running at a capital loss. In other words, if the asset were to be sold at the time of joining the group, a loss would arise.

23.6 Calculating pre-entry capital losses

The two methods are **time apportionment** or **market value**. In order to use the market value rule, we must physically make an election.

TCGA 1992, Sch 7A Para 2

Illustration 5

Winston Limited acquires a plot of land on 1 March 2001 for £750,000. It joins the Churchill Limited group on 1 June 2006 when the land is worth £300,000. The land is sold on 1 June 2011 for £100,000. We need to calculate the pre-entry capital loss under each of the two methods.

The asset was purchased on 1 March 2001 and sold on 1 June 2011. It was held by the company for 10 years and 3 months in total. When the asset was sold, a capital loss of £650,000 was realised.

On 1 June 2006, Winston Limited joined the Churchill Group. Consequently, the pre-entry period is 5 years and 3 months and the post-entry period is exactly 5 years.

The pre-entry capital losses are restricted in usage and under the time apportionment method they work out to be:

$$£650{,}000 \times 5\frac{3}{12} \;/\; 10\frac{3}{12} = £332{,}927$$

The post-entry fully usable losses are therefore:

$$£650{,}000 - 332{,}927 = £317{,}073$$

However, an **election can be made to calculate these pre-entry losses based on the market value of the asset** at the time the company joined the group.

TCGA 1992, Sch 7A Para 5

If the asset was sold at the time Winston Ltd joins the Churchill Group, the pre-entry capital loss would have been £450,000, reducing the post-entry fully usable loss to £200,000. In this situation, as the election increases the restricted pre-entry loss, it should not be made.

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Example 2

Oxford Ltd acquired a building on 1 May 1999 for £600,000 and sold it on 1 September 2010 for £100,000. Oxford Ltd was purchased by Cambridge Limited on 1 January 2003 when the building was worth £450,000.

Assuming any beneficial elections are made, what are the fully relievable post entry capital losses?

23.7 Loss buying: tax avoidance schemes

TCGA 1992, s.184A

In addition to the pre entry loss rules above Finance Act 2006 introduced rules aimed at avoidance schemes. These rules take precedence over the pre-entry loss rules where applicable.

The rules state that a qualifying loss accruing to the company is not to be deductible from any chargeable gains accruing to the company.

TCGA 1992, s.184A Para 2

This rule applies where:

- there is a qualifying change of ownership of the relevant company;
- a loss (a *qualifying loss*) accrues to the relevant company or to any other company on the disposal at any time of a pre-change asset;
- the change of ownership is part of an arrangement, one of the main objects of which was to obtain a tax advantage by deducting the qualifying loss from any chargeable gain.

The definition of 'arrangements' includes any agreement, understanding, scheme, transaction or series of transactions, whether or not legally enforceable.

"Tax advantage" means relief or increased relief from corporation tax, repayment or increased repayment of corporation tax, the avoidance or reduction of a charge to corporation tax or an assessment to corporation tax, or the avoidance of a possible assessment to corporation tax.

TCGA 1992, s.184D

The restriction will apply whether:

TCGA 1992, s.184A(5)

(i) a qualifying loss accrues before, after or at the change in ownership;
(ii) a qualifying loss accrues at a time when there are no chargeable gains from which it could be deducted (or could otherwise have been deducted); or
(iii) the tax advantage is secured for the company to which a qualifying loss accrues or for any other company (e.g. via a s.171A claim).

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Illustration 6

B Ltd is a company with realised but unrelieved capital losses. It has an issued share capital of 600 shares.

B Ltd issues 400 new shares with limited rights to X. The original shareholders sell their shares in B Ltd to group C, but because of the holding of X, B Ltd does not become a member of the C group.

C has just acquired assets which are expected to rise in value, and transfers them at cost to B Ltd in the expectation that when they are sold, the gains will be reduced by the losses.

The issue of shares with limited rights and the sale of the remaining shares to C group is an arrangement designed to obtain a tax advantage, and the loss is a qualifying loss and cannot be deducted from post-change gains.

Illustration 7

Y plc is the principal company of a property group that includes a subsidiary company X Ltd. X Ltd owns a property in the centre of London with a base cost of £1bn. The property was previously acquired from a fellow group company at no gain no loss when the market value of the property stood at £900m.

X Ltd issues shares to an unconnected party, B Ltd, to the extent that B Ltd holds 30% of the issued share capital of X Ltd and so X Ltd is no longer a member of the Y plc group.

These new shares had very restricted rights compared to those already in issue. The presence of only very restricted rights attached to the new shares indicates that Y plc has no intention of making any material disposal of its economic interest in the property.

In the absence of the new legislation the fact that X Ltd is no longer part of the group headed by Y plc triggers the de-grouping provisions, and a capital loss is realised, reflecting the £100m fall in value to the date of the intra group transfer.

In this example it is clear that Y plc has taken advantage of the state of the property market in order to realise a loss for tax purposes even though there has been no genuine disposal, either of the asset whose value was reduced, or of the company that owns it.

A loss has arisen to a company directly in consequence of arrangements, the main purpose of which is to secure a tax advantage. The legislation provides that the loss arises in disqualifying circumstances and is not therefore an allowable loss.

However, if in the above example B Ltd genuinely wished to enter into a joint venture involving the property, then a different outcome can be expected. It would have subscribed for shares that had rights comparable to those in issue, so that it acquired a corresponding share of the economic value of X Ltd. In those circumstances, securing a tax advantage is unlikely to have been the main purpose of the transaction.

A change in ownership arises when a company joins or leaves a capital gains group or there is a change in its control.

TCGA 1992, s.184C

A change of control is as defined by s.450 CTA 2010 thus it is the wide definition which includes any group of persons that can exercise control over the company's affairs.

The change of control rules are subject to two exceptions:

TCGA 1992, s.184C(7)

(i) where a new principal company is placed above an existing CGT group;
(ii) reconstructions wholly within a CGT group.

A pre-change asset is an asset owned by the company before the change in ownership.

An asset will only cease to be a pre-change asset if it is disposed of by the company which changed ownership other than by a no gain no loss disposal.

TCGA 1992, s.184E

In the case of a part disposal the remaining part remains a pre-change asset as do assets derived from pre–change assets.

If the asset consists of shares and securities such that the rules relating to re-organisations and takeovers apply the new holdings received will be treated as pre-change assets.

If there is a reconstruction involving the transfer of a business under s139 TCGA 1992, the new shares acquired by the shareholders are treated as pre-change assets.
However, the new owner of the trade will not be treated as acquiring pre-change assets unless arrangements have been entered into to avoid tax.

Where tax rules result in the deferral of a gain or loss on a pre change asset, then when the deferral ends the pre-change asset rules are applied to that part of the resulting gain or loss.

Where assets are pooled for capital gains tax purposes, separate pools are treated as created for pre and post change assets. On a disposal, assets acquired after the change are treated as disposed of first. This rule cannot be superseded by a sale agreement.

TCGA 1992, s.184F

If we revisit Winston Limited in Illustration 5 we can see that the availability of what we determined to be the post entry loss needs to be reconsidered. The loss will only be available provided that the purchase of Winston Limited by the Churchill group was not in connection with arrangements aimed at securing a tax advantage. HMRC in their guidance notes point out that they have encountered schemes where the purchasing company is happy to accept that not all the loss will be available because of the application of the pre-entry loss rules.

As stated above for disposals occurring on or after 21 March 2007, the qualifying loss cannot be deducted from chargeable gains accruing to the company. This ensures that a company with qualifying losses cannot use them to reduce gains on the disposal of shares in a directly held subsidiary where the gains are attributable to an increase in the value of assets the subsidiary holds, but which were acquired after the change of ownership.

HMRC have provided guidance on some of the terms set down in the SSE legislation.

23.8 Gain buying: tax avoidance schemes

TCGA 1992, s.184B

The rules on gain buying prevent a company from setting a loss against a qualifying gain.

TCGA 1992, s.184B(2)

This rule applies where:

- there is a qualifying change of ownership of the relevant company;
- a gain (a *qualifying gain*) accrues to the relevant company or to any other company on the disposal at any time of a pre-change asset;
- the change of ownership is part of an arrangement, one of the main objects of which was to obtain a tax advantage by deducting a loss from the qualifying gain.

It does not matter whether:

TCGA 1992, s.184B(5)

(i) a qualifying gain accrues before, after or at the time of the change in ownership;
(ii) a qualifying gain accrues at a time when there are no losses which could be deducted (or could otherwise have been deducted) from the gain; or
(iii) the tax advantage is secured for the company to which a qualifying gain accrues or for any other company.

The definitions listed above for loss buying apply equally to gain buying.

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The new rules on loss and gain buying apply for calculating the amount to be included in respect of chargeable gains in a company's total profits for any accounting period ending on or after 5 December 2005. However they do not have effect in relation to the deduction of any loss from chargeable gains that accrue on any disposal made before 5 December 2005 unless that loss accrues on a disposal made on or after that date.

It does not matter whether a qualifying change of ownership in relation to a company occurs before 5 December 2005, or on or after that date.

For disposals occurring on or after 21 March 2007, a capital loss cannot be deducted from a qualifying gain accruing to the company (as stated above). This amendment was introduced to block a loophole in the original legislation.

A clearance procedure is available for transactions which may be caught by these rules. New guidance was issued in March 2007.

The above rules are often referred to an TAARs (Targeted Anti Avoidance Rules). TAAR 2 and TAAR 3 deal with schemes which convert income into capital and schemes which secure a tax deduction these as explained below.

23.9 Avoidance involving losses

TCGA 1992, s.184G & s.184H

For disposals on or after 5 December 2005 HMRC can issue a notice to a company denying loss relief if arrangements have been entered into to convert income to capital or to secure a deduction that would not otherwise be available.

a) Schemes converting income to capital

TCGA 1992, s.184G

A notice will be issued in respect of income conversion where:

- any receipt arises to a company ("the relevant company") on a disposal of an asset, and the receipt arises directly or indirectly in consequence of, or otherwise in connection with, any arrangements;

- a chargeable gain (the "relevant gain") accrues to the relevant company on the disposal, and losses accrue (or have accrued) to the relevant company on any other disposal of any asset (whether before or after or as part of the arrangements);
- but for the arrangements, an amount would have fallen to be taken into account wholly or partly instead of the receipt in calculating the income chargeable to corporation tax of the relevant company, or of a company which, at any qualifying time, is a member of the same group as the relevant company;
- the main purpose of the arrangements, or one of the main purposes of the arrangements, is to secure a tax advantage that involves the deduction of any of the losses from the relevant gain (whether or not it also involves anything else).

Where a notice is given no loss accruing to the relevant company at any time is to be deductible from the relevant gain.

This legislation has been introduced as a safeguard against future schemes.

b) Schemes securing a deduction

TCGA 1992, s.184H

A notice will be issued denying loss relief for schemes involving securing a deduction where

- a chargeable gain (the "relevant gain") accrues to a company ("the relevant company") directly or indirectly in consequence of, or otherwise in connection with, any arrangements, and losses accrue (or have accrued) to the relevant company on any disposal of any asset (whether before or after or as part of the arrangements).
- the relevant company, or a company connected with the relevant company, incurs any expenditure which is allowable as a deduction in calculating its total profits chargeable to corporation tax but which is not allowable as a deduction in computing its gains, and which is incurred directly or indirectly in consequence of, or otherwise in connection with, the arrangements.
- The main purpose, or one of the main purposes, of the arrangements is to secure a tax advantage that involves both the deduction of the expenditure in calculating total profits, and the deduction of any of the losses from the relevant gain, whether or not it also involves anything else.
- The arrangements are not excluded arrangements. In summary excluded arrangements are those relating to sale and lease-back of land to a third party at arm's length.

23.10 Issue of notice by HMRC

For both s.184G and s.184H TCGA 1992 cases, denial of the loss only occurs on the issue of a notice by HMRC - the company is not under any obligation to self assess.

The notice must:

(a) specify the arrangements;

(b) specify the accounting period in which the relevant gain accrues; and

(c) inform the relevant company of the effect of this section.

If relevant gains accrue in more than one accounting period, a single notice may specify all the accounting periods concerned.

Notices may be issued before or after the company has filed its CT600. If the return has been made a notice can only be issued once an enquiry has been opened, or as an alternative, under the discovery rules.

Following the issue of a notice a company has 90 days to consider the impact on its return. In the case of an enquiry no closure notice can be issued until the 90 days expires.

Where the relevant notice is issued after enquiries into the return are completed, no discovery assessment may be made until 90 days after the issue of the notice or (if earlier) the time when the company amended its return in accordance with the notice.

The legislation does not specify what happens if the company does not amend its return within the 90 day period. Where the enquiry into the return has not been completed, presumably HMRC can amend the return and the company can appeal against the amendment under the normal self-assessment rules. There is no provision for an appeal against a notice.

A return will be incorrect if it is not amended within the 90 days. This is to protect HMRC's right to penalties or to take action to obtain a correct return.

A clearance procedure is available for transactions which may be caught by these rules.

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Answer 1

At the time of the property transfer both companies are part of the same group so this transfer will have been at no gain no loss.

However, in January 2011, Fish Limited leaves Cage Limited's group and is treated as disposing of the asset for market value at the date of transfer and immediately reacquiring it. This gives us proceeds of £480,000 less cost, less indexation leaving us with a gain of £277,500. This gain will be taxed on Fish Limited in the accounting period in which it leaves the group.

Answer 2

Oxford Limited purchased a property on 1 May 1999 for £600,000 and sold it on 1 September 2010 for £100,000, realising a capital loss of £500,000. The asset was owned for 11 years and 4 months in total.

On 1 January 2003, Oxford Limited joins the Cambridge Group, and the pre-entry period is therefore 3 years and 8 months. Computing, using the normal time apportionment rule, we show a pre-entry loss of:

$$£500{,}000 \times \frac{3 \text{ years } 8 \text{ months}}{11 \text{ years } 4 \text{ months}} = £161{,}765$$

However, by making an election the company can deem that the asset was sold at the time it joined the group.

This would give a pre-entry loss of:

£(600,000 – 450,000) = £150,000

which is lower than the time apportionment figure which therefore means we will increase the usable post-entry loss.

Consequently, the election is worthwhile and the post-entry loss is calculated as follows:

£(500,000 – 150,000) = £350,000