Chartered Institute of Taxation.

30 Monck Street
London SW1P 2AP
T: +44 (0)20 7340 0550
E: technical@ciot.org.uk

Concerns around the interpretation of TCGA 1992 s.162

Budget representation by the Chartered Institute of Taxation

1. Executive Summary

1.1. The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 20,000 members, and extensive volunteer network, in providing our response.

1.2. This submission concerns Taxation of Chargeable Gains Act (TCGA) 1992 s.162 and is made further to a separate submission made by the CIOT concerning ESC D32. We have wider concerns with s.162 itself especially concerning the definition of a business's assets and are calling for greater HMRC guidance on the status of those and their legal/beneficial titles, or potentially changes of the wording of s.162.

2. About us

2.1. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

2.2. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

2.3. The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

2.4. Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

3. Introduction

3.1. We outline the current position regarding s.162 and our areas of concern with this legislation. The points made in this representation are similar to those made in a separate representation concerning ESC D32 specifically, which HMRC have acknowledged and are liaising with CIOT to update the relevant guidance[1] .

3.2. Our stated objective for the tax systems include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

4. Section 162 – whole assets of the business requirement

4.1. The legislation specifically states that all the business's assets except for cash must be transferred to the company for incorporation relief to be available. The issue here is whether the reference to the company's assets means chargeable assets (ie those assets on which capital gains tax might arise on a disposal) or all the assets of the company, whether chargeable or not. It is not clear what policy end is served by the requirement that all assets of the business be transferred, so long as the business, in itself, is transferred as a going concern.

4.2. The issue occasionally comes up in situations where there might be a commercial requirement to retain some of the non-chargeable assets on incorporation. An example we have seen on more than one occasion is where the business does not currently hold enough cash to pay all its creditors. They would prefer to be able to retain some of the debtors, so that as those debts are paid, cash is generated to repay creditors. Unfortunately, because of the uncertainty as to the meaning of the word 'assets' in this context, we generally advise clients that it is better to defer the incorporation, rather than retaining debtors and risking the loss of the incorporation relief.

4.3. This matter was brought up in a recent meeting of the Capital Taxes Liaison Group and HMRC representatives in the group expressed a willingness to engage with us to discuss this further.

4.4. Another issue that occasionally comes up is where the business assets include the property from where the business is carried on, and the transferor(s) would prefer to retain ownership of the property and grant a lease to the company to allow the trade to be continued from that site. In our view, this is clearly a transfer of the business as a going concern, but the failure to transfer the property would mean that incorporation relief would not be available. As a result, business owners wanting to incorporate are required to transfer properties to the company, in many cases incurring further costs of conveyancing and other associated fees, as well as stamp duty land tax.

4.5. We also see the matter arise in 'group' reconstructions involving a business carried on by a partnership (including an LLP). If the partnership carries on a trade and holds assets which are used in that trade, as well as other assets that are not used in the trade, for example, shareholdings in 'subsidiary' companies, it is unclear if incorporation relief is available to individual partners if the partnership transfers to a company its trade along with the assets used in the trade, such that the trade is transferred as a going concern, but does not transfer

[1] Uncertainties in relation to the application of ESC D32 - CIOT submission (tax.org.uk)

the assets which are not used in the trade to the company. If the trade was carried on by a sole trader, they would not be expected to transfer separate investment assets held in order to benefit from incorporation relief, so there does not appear to be any policy reason why those in partnership would need to transfer all of the assets of the partnership, irrespective of whether they are used in the trade being transferred, to qualify for the relief.

4.6. The question of why it is considered necessary to transfer all the assets of the business to the company is one which we would like to open discussions with HMRC. We cannot see that transferring a business without all of its assets would lead to any loss of tax to the Exchequer. Indeed, precisely the opposite is the case, because if chargeable assets are transferred to a company on incorporation, no capital gains tax rises but the assets are rebased to market value in the company. If, therefore, the company subsequently sold such assets, any chargeable gains are lower than would have been the case if the assets concerned had been sold directly by the individuals.

4.7. In terms of resolutions, we believe that the issue around transferring debtors or other non-chargeable assets could be resolved by HMRC making it clear in their manuals that they would accept that, in the context of this provision, the word 'assets' refers to chargeable assets. It would further be helpful if it can be clarified that only the chargeable assets used in the business subject to the transfer are required to be transferred. Of course, a preferable solution would be to amend the legislation to clarify the point, but we appreciate that Parliamentary time is tight.

5. Section 162 – legal and beneficial ownership of assets

5.1. Another relatively common piece of planning carried out concerning property business incorporations is to transfer the beneficial ownership of the properties into the company, while the transferor(s) retain the legal title. This is not intended as a tax play, rather to avoid having to refinance properties through the transfer of legal ownership.

5.2. There is some uncertainty as to whether s.162 incorporation relief may be effective with respect to the 'whole assets of a business' if only the beneficial ownership is transferred into the company whilst legal ownership, as a separate asset, remains with the individual. For tax purposes more generally it is only beneficial ownership of a particular asset that is relevant; legal ownership alone does not confer the ability to occupy and use an asset for business use. We would suggest that Parliament had intended a purposive approach to s.162 concerning the interpretation of 'assets of the business' and that a broad commercial view of a 'going concern' is one whereby the beneficial ownership is the only valuable asset of the business. However, clarity is urgently needed on this point, so we would ask HMRC to confirm their view as to whether 'assets of the business' simply means the beneficial ownership.

5.3. To highlight the nature of the debate as to whether legal ownership is an asset with respect to s.162, some advisers suggest that the situation was resolved by the decision in *CIR v Gordon*[2]. The essence of this case (paraphrasing the facts, which refer to Scots land law) was that a partnership was incorporated and the beneficial interest held by the partnership was transferred to the company. The underlying legal ownership was never held by the partnership and, therefore, was never transferred to the company – however the Court of Session allowed the incorporation relief on appeal. The facts of the case being markedly different to that of a common incorporation scenario does render it of limited use, but it does demonstrate an acceptance that a business can operate as a going concern possessing only the beneficial ownership of its assets.

[2] [1991] STC 178

5.4. Our current concern is that a large number of taxpayers who have incorporated property businesses in this way, ie by transferring beneficial but not legal ownership to a company, are now concerned (particularly since the publicity given to this sort of planning by Tax Policy Associates, amongst others), that they may be subject to large capital gains tax charges on the basis that the incorporation of the property businesses did not satisfy the terms of s. 162. It would, therefore, be helpful for HMRC to clarify the position to avoid future uncertainty.

5.5. At a recent meeting of the Capital Taxes Liaison Group, this point was brought up and the HMRC representative (not the same one as mentioned above in 4.3) noted that they were aware of the issue and would be willing to engage with us to discuss this matter in more detail.

5.6. If HMRC's view is that the transfer of beneficial ownership alone may not qualify for incorporation relief, it may be necessary as well to consider whether some kind of amnesty might be appropriate for people who have unwittingly followed the advice to incorporate their property businesses in this way.

6. Acknowledgement of submission

6.1. We would be grateful if you could acknowledge safe receipt of this representation, and ensure that the Chartered Institute of Taxation is included in the List of Respondents if any further correspondence or consultations are released on this matter.

The Chartered Institute of Taxation

29 August 2024