



Excerpt from Incorporating and Disincorporating a Business - Chapter 17 - Incorporation of a rental property business

Capital gains tax

17.19

With historic rises in property prices, getting the assets of the business into the company almost inevitably leaves a property investor facing a large capital gain on incorporation.

There are two traditional routes of relieving the capital gains arising on incorporation of a business. These use either the general relief for gifts of business assets in TCGA 1992, s 165, or the specific incorporation relief in s 162 (see Chapter 5).

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TCGA 1992, s 165 is a non-starter here. This permits the holdover of a capital gain where an asset is transferred at undervalue and the asset is used for the purposes of a trade, profession or vocation. Whatever property letting may be, it is not a trade, profession or vocation (although furnished holiday lettings (see 17.26) can be treated as a trade for s 165 and some other tax purposes, if certain conditions are satisfied).

Incorporation relief

17.21

Therefore, to succeed, we would normally have to rely on s 162, which provides a mandatory rollover of the gain where a person who is not a company transfers to a company a business as a going concern, together with the whole assets of the business, in return for the issue of shares.

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There is no definition of the term 'business' in TCGA 1992, for this or any other purpose of CGT.

The question of what constitutes a business for these purposes has already been considered in 17.6–17.14 above.

Guidance must, therefore, be taken from the Elisabeth Moyne Ramsay case (see 17.15–17.16) where the taxpayer successfully claimed s 162 relief on the incorporation of a property lettings business.

17.23

TCGA 1992, s 162 not only requires the transfer of the business, but of the business as a going concern. Can a property-letting business be a going concern?

This issue was not raised in the Elisabeth Moyne Ramsay case, so presumably the answer is 'yes'.

Despite the taxpayer's success in the Elisabeth Moyne Ramsay case, a cautious approach is still to be advocated in relation to property portfolio incorporations. If one were to try such an incorporation, and it was successfully challenged by HMRC on enquiry – being somehow distinguishable from the Elisabeth Moyne Ramsay case – then a very large unrelieved gain could ensue with no cash having been generated to meet the liability.

HMRC's guidance states (at CG65715): 'It is a question of fact whether a particular activity constitutes a business. It is not easy to draw the line, and each case must be judged on its own facts.'

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The uncertainty on this issue will clearly be unsatisfactory for those taxpayers seeking to rely on incorporation relief under TCGA 1992, s 162. This has resulted in some taxpayers (or their advisers) seeking advance assurance from HMRC under the non-statutory business clearance service that their undertaking amounts to a business for these purposes.

There is no statutory clearance on the availability of s 162 relief. HMRC provides a non-statutory business clearance facility in certain circumstances (see www.gov.uk/guidance/non-statutory-clearance-service-guidance). As indicated above, taxpayers have sought to use this service in the context of incorporations of rental property businesses.

However, HMRC changed its guidance on when it would not give advice under the non-statutory clearance service in May 2018. The amended guidance states that HMRC will not give a clearance on matters of fact, such as if certain activities constitute a business.

This restriction in the scope of non-statutory clearance applications is particularly unhelpful if there is uncertainty in the above area, where the incorporation of buy-to-let residential property activities is being considered. However, the above change was not completely unexpected; there was previously anecdotal evidence that HMRC had been unwilling to provide its view in some cases, on the grounds that HMRC was unwilling to assist in tax planning exercises.

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As indicated at 5.23, HMRC's Concession D32 provides that relief under s 162 is not precluded by the fact that some or all of the liabilities of the business are not taken over by the company.

However, care is needed to ensure that liabilities remain within the terms of Concession D32. For example, if the company raises finance and uses the funds to pay the proprietors for the business to enable existing property borrowings to be repaid, this will constitute (non-share) consideration for the business, resulting in any s 162 relief being restricted.

Furnished holiday lettings

17.26

Where properties meet the conditions to be treated as furnished holiday lettings ITTOIA 2005, Pt 3, Ch 6 ('Commercial Letting of Furnished Holiday Accommodation') then they are automatically deemed to be a trade for certain tax purposes.

The conditions (in ITTOIA 2005, s 325) are broadly that:

- there is a commercial letting of property with a view to the realisation of profit;
- the letting is of furnished accommodation;

- the accommodation is available for commercial letting to the public generally as holiday accommodation for a period of not less than 210 days in the ‘relevant period’ as defined (ie normally the tax year);
- the accommodation is actually commercially let as holiday accommodation to the public for at least 105 days in the relevant period;
- for periods totalling not more than 155 days in the relevant period it is not normally in the same occupation for a continuous period exceeding 31 days.

17.27

Focus

favoured CGT treatment potentially available in respect of the commercial letting of furnished holiday accommodation (TCGA 1992, ss 241, 241A) is not afforded to property rental businesses generally.

Furnished holiday lettings in the UK are generally treated as forming a single trade, and similarly an overseas property business of furnished holiday lettings in one or more EEA states is generally treated as forming a single trade, for the purposes of the capital gains reliefs listed in TCGA 1992, ss 241(3A), 241A(5), which include entrepreneurs’ relief (see 17.29), gifts relief (see 17.30) and rollover relief on replacement of business assets.

Furthermore, incorporation relief under TCGA 1992, s 162 is potentially available to furnished holiday lettings businesses, as it generally is to other types of property rental businesses.

17.28

For entrepreneurs’ relief purposes, ‘a business’ is defined as anything which is a trade, profession or vocation, and is conducted on a commercial basis and with a view to the realisation of profits (TCGA 1992, s 169S(1)). A residential rental property activity is capable of amounting to a business, but will not normally be treated as a trading activity.

HMRC relies on case law (*Salisbury House Estates Ltd v Fry* [1930] 15 TC 266 and *Griffiths v Jackson* [1982] 56 TC 583) as authority to support its view that income derived from rights of property in land is very unlikely to be trading income except in a hotel or guesthouse activity, where the whole income from guests is usually chargeable as trading income. The fact that the taxpayer spends a lot (or even all) of their working time in the letting business does not convert rental income into trading income in HMRC’s view (see PIM1051).

17.29

However, an important exception to this general rule for entrepreneurs’ relief purposes applies in the case of qualifying furnished holiday lettings (TCGA 1992, ss 241(3A), 241A(5)). This exception potentially provides the individual furnished holiday lettings business proprietor with the opportunity to sell the business to the company upon incorporation (in return for cash and/or a loan account balance with the company) and claim entrepreneurs’ relief if the relevant conditions are satisfied. This may be a more tax-efficient means of extracting profits from the company than (for example) salary or dividends, although as always this will depend on the particular facts in each case.

The availability of entrepreneurs’ relief on disposals of goodwill upon incorporation is restricted in respect of goodwill transfers to a close company, subject to certain limited exceptions (see TCGA 1992, s 169LA). The effect of the restriction is to exclude goodwill from the definition of ‘relevant

business assets' comprised in a 'qualifying business disposal' for entrepreneurs' relief purposes (in TCGA 1992, s 169L), so that a gain on an affected disposal of goodwill to the close company (or a company that would be close if it were resident in the UK) is charged at normal CGT rates (subject to other reliefs being claimed). Consideration should therefore be given instead to whether there is any goodwill value in the business, including any property.

Where the furnished holiday lettings business consists of a single property that is sold upon incorporation, clearly the business has ceased and there has been a disposal of the whole business. However, where the furnished holiday lettings business contains several let properties and there is a disposal of only some of those properties, a claim for entrepreneurs' relief may be challenged by HMRC, on the basis that there has been no disposal of part of the business as required for relief purposes, but merely the disposal of business assets (see HMRC's Capital Gains manual at CG64015 and following).

Note that TCGA 1992, s 169I(7ZA)–(7ZB) were introduced by FA 2019 and provide that a pre-transfer ownership period may be taken into account in determining whether the qualifying ownership period, extended to two years, is met for entrepreneurs' relief purposes.

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In the context of the incorporation of a rental property business, relief under TCGA 1992, s 165 is not generally available. This is because the relief permits the holdover of a capital gain where an asset is transferred at undervalue and the asset is used for the purposes of a trade, profession or vocation. As indicated at 17.20 above, a buy-to-let residential property activity will not normally be treated as a trading activity (or a profession or vocation).

Focus

However, a qualifying furnished holiday lettings business is treated as a trade for the purposes of relief under TCGA 1992, s 165 (see TCGA 1992, ss 241(3A), 241A(5)). See Chapter 5.

It is therefore possible for an individual to transfer a property used for furnished holiday letting at undervalue to a company and hold over a capital gain arising by making a claim under s 165. In other words, it is possible to incorporate a property-letting business which consists entirely of furnished holiday lettings without triggering a taxable capital gain using this relief.

It should be noted that the property has to have been in 'trade' use just before it is gifted. Previous periods of non-trade use will generally restrict the relief (TCGA 1992, Sch 7, para 5). Similarly, if part of the property was used for the purposes of the trade and part of it was not, gift holdover relief is generally subject to a restriction on a 'just and reasonable' basis (Sch 7, para 6).

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