HM Revenue & Customs

Help Sheet 276

Tax year 6 April 2008 to 5 April 2009

Incorporation relief

Contacts

Please phone:
- the number printed on page TR 1 of your Return
- the Helpline on **0845 9000 444**
- the Orderline on **0845 9000 404** for Help Sheets

or go to **www.hmrc.gov.uk**

This Help Sheet gives you information about the relief which is available if you incorporate your business. It also gives you information about what to do if you do not want the relief to apply. It is only an introduction and if you are in any doubt about your circumstances you should ask your tax adviser. We will also be pleased to help. You can also consult our Capital Gains Manual, which explains the rules in more detail, at **www.hmrc.gov.uk**

This Help Sheet will help you fill in the *Capital gains summary* pages of your Tax Return.

Introduction

If you, either as an individual or in partnership, incorporate a business by transferring the business, together with all the assets of the business, in exchange wholly or partly for shares, you can defer some or all of the gain arising from the disposal of the 'old assets' (the business and the assets of the business) until such time as you dispose of the 'new assets' (the shares).

This relief is given automatically by Section 162 Taxation of Chargeable Gains Act 1992 provided the various requirements are met. This may not always be to your advantage.

If you do not want incorporation relief to apply on the transfer of your business, you can elect that Section 162 shall not apply by writing to us.

What is incorporation relief?

If you incorporate your business by transferring the business and all the assets of the business to a new or existing company, you are treated as if you had disposed of the assets for their market value. This may give rise to a chargeable gain based broadly on the difference between the market value of the assets and their original cost to you. Incorporation relief is given if:

- the business together with the whole of its assets (or all its assets other than cash) is transferred, and
- the business is transferred as a going concern, and
- the business is transferred in exchange wholly or partly for shares in the transferee company.

The relief is given automatically and there is no need to make a claim. The relief works by reducing the base cost of the new assets by a proportion of the gain arising from the disposal of the old assets.

Example 1

John Smith incorporated his business in May 2008 and received 1,000 £1 ordinary shares in ABC Ltd. The business was worth £100,000 on incorporation, so that the shares had a market value of £100 each, and the agreed chargeable gain on the assets transferred amounted to £50,000. Mr Smith does not pay Capital Gains Tax immediately. His cost of the shares for the purposes of any future disposal would normally be £100,000 but this is reduced by the amount of the deferred gain £50,000, leaving a base cost of £50,000.

Example 2

Bill Brown incorporated his business in May 2008 and received 1,000 £1 ordinary shares in CDE Ltd and £20,000 in cash. The business was worth £100,000 on incorporation, so that the shares had a market value of £80 each, and the agreed chargeable gain on the assets transferred amounted to £50,000. Mr Brown does not pay all of the Capital Gains Tax immediately. The part of the gain attributable to the consideration in shares is £50,000 x £80,000/£100,000 = £40,000. This part of the gain is deferred. His cost of the shares for the purposes of any future disposal would normally be £80,000 but this is reduced by the amount of the deferred gain £40,000, leaving a base cost of £40,000. Mr Brown is liable to tax on the balance of the chargeable gain, £10,000, for the year 2008-09.

How can you elect not to have incorporation relief?

For transfers on or after 6 April 2002, you can elect for Section 162 Taxation of Chargeable Gains Act 1992 not to apply. This may be done by giving notice in writing to us before the relevant date.

The relevant date depends on whether or not you dispose of the shares you received in exchange for the business and, if so, when that disposal takes place.

If you sell all the shares before the end of the tax year following the one in which the transfer of the business took place, you must notify us before the first anniversary of the 31 January next following the tax year in which the transfer took place.

Example 3

Mr Green transfers his business to XYZ Ltd in exchange for shares in October 2007 (2007-08). Mr Green sells his shares in XYZ Ltd in March 2009 (2008-09). Mr Green must make an election before 31 January 2010 if he does not want incorporation relief.

In all other cases, an election may be made before the second anniversary of the 31 January next following the tax year in which the transfer took place.

Example 4

Mr Black transfers his business to PQR Ltd in exchange for shares in October 2008 (2008-09). Mr Black retains his shares but nevertheless does not want incorporation relief. Mr Black must make an election before 31 January 2012.

What if you transfer the shares to your spouse or civil partner?

If you transfer the shares you received in exchange for the business to your spouse or civil partner, with whom you are living, by way of gift or sale, this is not treated as a disposal for the purposes of election, provided that the transfer is under circumstances where Section 58(1) Taxation of Chargeable Gains 1992 applies (see Help Sheet 281 *Husband and wife, civil partners, divorce, dissolution and separation*, available from the Orderline and at **www.hmrc.gov.uk**).

This means that your relevant date for making an election continues to be the second anniversary of the 31 January next following the tax year in which the transfer took place.

If your spouse or civil partner disposes of the shares to anyone other than back to you, that disposal is regarded as a disposal by you for the purposes of deciding which is the relevant date for making an election.

What if you only owned part of the business and the other owners do not want to elect out of incorporation relief?

If the business was owned by more than one person, whether or not in partnership, each person has a separate entitlement to make an election.
So you can make your own election independently of the other shareholders.

What if you want incorporation relief to apply?

Provided the transfer of the business fulfils the requirements of Section 162 Taxation of Chargeable Gains Act 1992, you do not need to do anything as the relief is given without a claim.

These notes are for guidance only and reflect the position at the time of writing. They do not affect any rights of appeal.