

B9.114 Transfer of liabilities on incorporation

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Business liabilities

Strictly, business liabilities taken over by the company represent additional consideration for the transfer and incorporation relief should be restricted, as this contravenes the provision that the relief is only available where the transfer is wholly or partly in consideration for the issue of shares (see B9.111). However, by concession HMRC does not treat such liabilities as part of the consideration for the transfer, so if the other conditions of TCGA 1992, s 162 outlined in B9.112 are satisfied, full incorporation relief is still available. Relief is also not precluded by the fact that some or all of the liabilities of the business are not taken over by the company. In practice, however, it is usually convenient for the company to take over the business liabilities and this is usually effected by the company giving the transferor an indemnity in respect of those liabilities.

It should be noted that the concession only applies in establishing whether the relief is available. It has no bearing in determining the net cost of the shares.

As explained in B9.113, when calculating the relief, the base cost of the shares cannot be reduced to a negative amount. A capital gain can, therefore, arise relatively easily where major liabilities are taken over by the company.

Example

Mr Linderman incorporated his business on 1 October wholly in return for shares.

His balance sheet was as follows:

	£
Goodwill	60,000
Freehold premises	150,000
Plant and machinery	20,000
Stock	30,000
Debtors	10,000
	<hr/> 270,000
Less: Current liabilities	(170,000)
	<hr/> 100,000

The gain on Mr Linderman's chargeable assets totalled £125,000. Before any incorporation relief, the value of the shares which he received for the transfer of his business would have been £100,000. However, since this value clearly cannot be reduced to a negative figure, the CGT legislation instead prescribes that it simply becomes nil, with the balance of the gains (ie £25,000) being taxable immediately.

Where the relief has been granted by virtue of the concession, there are measures to prevent taxpayers failing to account for any of the deferred gain when it subsequently becomes chargeable. The measures apply for any event occurring after 8 March 1999 (see C3.1910).

Personal liabilities

If, by contrast, liabilities which are not business liabilities are taken over by the company, these are treated as consideration other than in the form of shares, so that an immediate capital gains tax charge arises on part of the gain (see B9.113). Such non-business liabilities include the proprietor's capital and current accounts and income tax liabilities.

Buy-to-let properties

The incorporation of a buy-to-let property business (see B9.112), may involve refinancing the existing mortgages which could possibly prevent HMRC applying ESC D32. If the company does not assume the same liabilities of the transferor, but instead raises finance of its own, which is passed to the transferor to settle its debts related to the properties being transferred, there is considerable risk that HMRC might choose not to apply its concession. It is best to ensure that an appropriate restructuring of finance takes place before incorporation.