Having a takeout

Mark McLaughlin highlights some tax issues that advisers should consider when an asset is transferred from a company to its owners.


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Earlier this year, a readers' forum query 'Company residential property transfer to daughters' (*Taxation,* 28 February 2019, page 22) questioned the tax implications of the transfer of residential properties from a company to two daughters of the company's sole director and shareholder.

It is relatively common for assets to be transferred from a company on its winding up and, broadly, this was the scenario in the query. However, it is arguably less common and straightforward for company assets to be extracted in other circumstances, particularly in the form of directors' remuneration or a distribution to shareholders. Those other circumstances are considered in this article.

Let's assume the facts are as described in ***Take it away***.

No 'free lunch'

Most tax practitioners will be conscious of a perceived 'double tax charge' when an asset leaves a company. However, this is perhaps something of an over-simplification; tax charges can arise in respect of the same *asset*, but not normally on the same *person*.

In ***Take it away***, Carter Ltd transfers the vacant shop premises to Donald. The company receives no payment from Donald for the property.

For capital gains purposes, Carter Ltd and Donald are connected persons (TCGA 1992, s 286(6)). The disposal is therefore deemed to take place at market value (TCGA 1992, s 17 and s 18). A corporation tax liability arises for Carter Ltd on the resulting gain in its accounting period of disposal.

The second part of the double tax charge is a potential liability for Donald. The nature of the tax charge depends on how the property is extracted from the company. This article considers two alternative extraction methods: as employment income or as a shareholder distribution.

How much?

Suppose that the company directors (Donald and Hillary) would prefer the shop premises to be treated as employment income in Donald's hands. The voting and transfer of the property are reflected in the company paperwork (for example, in the meeting minutes).

The shop is not a readily convertible asset (within ITEPA 2003, s 702). The transfer of the shop to Donald will therefore be taxed as a benefit-in-kind. The cash equivalent of the shop needs to be established. This is broadly the cost of the benefit (see below), less any part of that cost made good by Donald to the company by 6 July in the following tax year (ITEPA 2003, s 203(2)).

Depending on the circumstances, there are different rules to determine the cost of a benefit for income tax purposes. In Donald's case, the asset transferred has been used by the company since it was acquired. The cost of the benefit is therefore its market value at the time of the transfer (see

Key points

- A practical example illustrates the extraction of assets from a limited company.
- The 'double charge' on asset extraction is on the same asset rather than the same person.
- The transfer could be treated as employment income and taxed as a benefit-in-kind.
- The benefit must be reported on a form P11D and class 1A National Insurance contributions will arise.
- A capital allowances adjustment may be required.
- A 'dividend in specie' is a distribution and a disposal by the company.

Take it away

Donald is a director (the only other director being his wife, Hillary), employee and the sole shareholder of Carter Ltd, which owns and operates a small chain of profitable American fast food takeaway outlets in the North East of England.

One of the takeaway outlets has recently closed down its trading operations. The building is currently worth £240,000 and is standing at a gain of £80,000.

Donald intends extracting the vacant shop premises from the company during 2019-20 (in other words, during Carter Ltd's accounting period ending 31 March 2020). Donald plans to use it as a temporary storage facility while his daughter Theresa is at college and is considering the possibility of giving her the premises to start a health supplement business after she completes her course.

ITEPA 2003, s 206(2)). The market value is defined (in ITEPA 2003, s 208) as the price it might reasonably be expected to fetch on a sale in the open market at that time.

Some care will be needed in establishing the market value of the shop premises – and also in disclosing the transfer and valuation in Donald's self-assessment return for the tax year of transfer – in terms of reducing the possibility of either an HMRC enquiry or a discovery assessment (see, for example, *Langham v Veltema* [2004] STC 544). Best practice will generally be to obtain an independent professional valuation.

P11D and capital allowances

The benefit must be reported on Donald's form P11D for 2019-20. Carter Ltd will be liable to class 1A National Insurance contributions at 13.8% on the benefit figure disclosed. As mentioned, the company will also be liable to corporation tax on the gain arising from the disposal of the shop premises. However, the company will be able to claim a deduction against trading income in respect of the value of the property, and also the class 1A contributions liability. The deduction for the shop should be accepted as being its market value (see HMRC's *Business Income Manual* at BIM47110).

The company will also need to consider its capital allowances position. For example, HMRC's view in relation to disposal values for plant and machinery purposes (say fridge-freezers, ovens, deep fat fryers in our takeaway example) is that an employer cannot be entitled to both a revenue deduction and a nil disposal value on transferring an asset to an employee. For the company to claim a revenue deduction, the transfer must have passed the 'wholly and exclusively' test. If it does, HMRC considers that the transfer cannot have been for no consideration. The company will therefore be required to bring a disposal value into the capital allowances computation (see HMRC's *Capital Allowances Manual* at CA23250). The disposal value would give rise to a balancing adjustment for Carter Ltd.

Share and share alike

What would be the tax position if, rather than passing the premises to Donald as employment income, the company voted a dividend in specie to Donald of the shop premises?

As far as Carter Ltd is concerned, a 'dividend in specie' (broadly a dividend satisfied by the transfer of an asset) is a distribution for corporation tax purposes (CTA 2010, s 1000(1)). No deduction from trading income will therefore be available to the company for the value of the distribution. For capital gains purposes, the dividend in specie is treated as a disposal by the company at market value (TCGA 1992, s 17(1)).

In practice, it would be prudent to check beforehand that the company is authorised under company law to make in specie dividends, particularly in the case of long-standing companies.

Nowadays, the power to make such distributions is normally given in the company's articles of association (for example, see article 34 of the model articles, available on GOV.UK at tinyurl.com/Model-Arts-Private-NCD). However, even if there is no authority to make in specie distributions, it should be possible to add such a power by special resolution.

The company law requirements for distributions are important and need to be considered carefully to avoid the distribution being unlawful and void. For example, Carter Ltd would need sufficient distributable reserves to cover the amount of the distribution. In many cases, a dividend in specie is expressed as a monetary amount, which is satisfied by transferring assets of an equal value to that amount. The monetary amount will often be the 'book value' of the asset (broadly its value in the company's balance sheet). However, if the asset has been revalued in the company's accounts, a surplus on revaluation is treated as a realised profit and included in distributable reserves (CA 2006, s 846).

For tax purposes, if the market value of an asset transferred is greater than the monetary value of a dividend in specie, the excess generally also falls to be treated as a distribution (under CTA 2010, s 1000(1)B – a 'distribution out of assets in respect of shares' – or s 1000(1)G, 'transfers of assets'). If the company satisfies the dividend by transferring the property without specifying any figure, the amount of the dividend is taken as the book value of the asset, and similar tax treatment applies.

For Donald, the dividend in specie is also a distribution for income tax purposes, which will be taxable on Donald at the appropriate dividend tax rate (probably 32.5% and/or 38.1%).

Spoilt for choice

In our ***Take it away*** example, it is assumed Carter Ltd has clearly indicated that the shop is to be transferred as employment income or a dividend in specie, and that the transfer is treated as such.

In some cases, there may be doubt about how a transfer should be taxed. For example, a transfer may fall to be treated as both employment income and a dividend. In such circumstances, dividend treatment generally takes precedence (ITEPA 2003, s 716A(1)).

If an employee who is also a shareholder receives a dividend, and HMRC disputes the tax treatment of the income as a dividend, the courts are likely to focus on the character of the receipt in the hands of the recipient.

For example, in *HMRC v PA Holdings Ltd (and cross-appeal)* [2012] STC 582 the court found that amounts received by employees were triggered by the employer's decision to continue its policy of making bonus payments, and 'arrived in the hands of employees, as they were intended to do, as bonuses'. The court held that if the payments were emoluments in the hands of the company's employees, they could not be dividends or distributions. The decision in *PA Holdings* has subsequently been considered in other cases (such as *James H Donald (Darvel) Ltd and Others v HMRC* [2015] UKUT 514 (TCC)).

However, in *PA Holdings*, the payments to employees were part of relatively complex arrangements whereby the employees who would have been paid bonuses were awarded shares and received dividends instead. The court (applying the principles in *WT Ramsay Ltd v CIR* [1982] AC 300) decided that the insertion of the steps which created the form of dividends or distributions did not deprive the payments of their character as emoluments.

By contrast, in the case of Carter Ltd and Donald, the transfer of the shop premises is a one-off event; there is no regular pattern of bonuses in previous years; and any distribution is not part of a complex arrangement to receive remuneration as the distribution. A dividend should not be treated as employment income in these circumstances.

It's mine, all mine!

For inheritance tax purposes, if a close company makes a transfer of value (say a property), the value transferred is generally apportioned between the participators in the company and is taxable as an immediately chargeable transfer. However, the amount apportioned is reduced by any increase in the individual's estate as a result of the transfer (IHTA 1984, s 94(1)).

In this case, Donald owns the entire share capital of Carter Ltd. There should be no overall loss in value of Donald's estate resulting from the transfer of the property to Donald because, in effect, the property remains within his estate.

In any event, no apportionment is made if the value transferred falls to be taken into account in computing the person's income (or gains or losses) for tax purposes (IHTA 1984, s 94(2)). To the extent that Donald will be taxed under the employment income or distribution provisions on the transfer of the shop premises, no apportionment will therefore be required. If any amount is apportioned to Donald, the availability of business property relief will need to be considered.

Sooner rather than later

The next point to consider is whether the company's transfer of the shop to Donald is liable to stamp duty land tax (SDLT). A distribution of this kind to a shareholder will not normally result in an SDLT liability because it is made for no consideration (FA 2003, Sch 3 para 1).

HMRC's view (albeit in the context of stamp duty) is that if a company declares a dividend, this is a voluntary disposition by a company to its shareholders, and so does not attract a charge. However, the department's guidance states that satisfying an obligation that has been created is the release of a debt (STSM021130).

Thus, if Carter Ltd declared a dividend for a specific monetary amount and satisfied that debt by transferring the property, HMRC would probably regard the debt created by the dividend as chargeable consideration for the property, and SDLT would become due and payable by Donald (FA 2003, Sch 4 para 8).

As indicated earlier, the company's procedure for the declaration and payment of dividends is normally stated in its articles of association. The model articles of association for private companies (as prescribed by The Companies (Model Articles) Regulations SI 2008/3229) provide that the company may declare dividends by ordinary resolution and the directors may 'decide' to pay interim dividends (tinyurl.com/Private-Co-Model-Arts-Dividend).

HMRC considers that a final dividend is normally due and payable when declared by the company in a general meeting (unless a future date is stipulated), but that an interim dividend may be varied or rescinded at any time before payment and may therefore be regarded as due and payable only when it is actually paid (*Potel v CIR; Poteliakhoff v CIR* (1970) 46 TC 658; see CTM15205). On that basis, an interim distribution of the property (and not of a specific monetary amount) may be preferable in terms of preventing the creation of a debt (which is satisfied by the transfer of the shop premises), and therefore preventing a potential SDLT liability.

Alternatively, if the property is to be treated as employment income, similar considerations apply in terms of preventing the creation of a debt for SDLT purposes.

Planning point

Note that if a dividend is declared for a specific monetary amount and that is satisfied by transferring property, HMRC could argue that the debt created by the dividend is chargeable consideration for the property resulting in a stamp duty land tax liability.

What about VAT?

Carter Ltd is VAT registered for its business. Hence it can generally decide whether to opt to tax (in other words strictly, elect to waive exemption on) its property. If it has not opted to tax, VAT will not be an issue. If it has opted to tax the property, VAT must be charged if there is a supply for consideration.

Consideration is any form of payment in money or in kind. A dividend will not normally be a supply and is therefore outside the scope of VAT because it is not payment for any supply by the shareholder; it is merely a share of the profit earned by the company. However, if the property is transferred in specie in satisfaction of an obligation previously created, HMRC may take a different view.

In the case of property transferred as a bonus, HMRC states that the provision of services by an employee to their employer is outside the scope of VAT. This is because the EC Principal VAT Directive defines a taxable person as a person acting independently, and Article 10 of the Directive provides that the term 'independently' excludes: 'employed and other persons from the tax in so far as they are bound to an employer by a contract of employment or by any legal ties creating the relationship of employer and employee as regards working conditions, remuneration and the employer's liability' (see HMRC's guidance at VATSC03540).

All together now

The transfer of an asset from a company in circumstances such as those in the example of Carter Ltd and Donald involves various tax issues for both the company and the individual, not to mention non-tax law (such as company and employment law) and commercial implications. For example, a building generally needs to be transferred by a written legal document (Law of Property Act 1925, s 53).

Concluding with the takeaway food theme, a holistic approach is the order of the day, to avoid unpalatable issues slipping onto the menu. ●

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