Bringing the group onshore

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My clients are UK tax residents and jointly hold a profitable UK trading company (TradeCo) via a holding company resident in the British Virgin Islands (BVI HoldCo). They are now keen to replace the BVI company with a UK holding company. How can this be achieved in a tax efficient manner?

Your clients are right to want to seek to eliminate the BVI company. Notwithstanding the current political climate concerning (perceived) tax avoidance, it is questionable whether the use of such an offshore entity achieves any tax advantages.

In particular, HMRC may look closely at where the BVI company is tax resident: if it is no more than a sham company under the control of the UK directors, it is likely to also be considered UK tax resident as discussed further below.

And even if the above issue can be overcome, any dividends paid up from TradeCo could be subject to tax under the transfer of assets abroad rules at ITA 2007 s 714. The potential impact of those provisions is however outside the scope of this article.

Taking into account the above, we recommend the following approach to eliminate the BVI company from the structure.

1. Insertion of new holding company

The two shareholders should firstly form a new UK company (UKCo) which can acquire the entire share capital of BVI HoldCo via a share for share exchange.

Such a reorganisation can be undertaken free of capital gains and income tax provided that the transaction is undertaken for bona fide commercial reasons and not for the avoidance of tax. Advance assurance should be sought from HMRC under the provisions of TCGA 1992 s 138 and ITA 2007 s 701 but insofar as this is purely a paper for paper exchange, we would not expect any undue difficulties in this regard.

The acquisition of shares in BVI HoldCo could strictly attract UK stamp duty if the document executing the transfer is dealt with in the UK. However, a claim for exemption from stamp duty can be made under FA 1986 s 77.

It should accordingly be possible to insert the new UK holding company on a tax-free basis.

Furthermore, the consideration shares issued by UKCo 'step into the shoes' of those previously held by the two shareholders in BVI HoldCo. Although not explicit in the legislation, this means that the holding period for entrepreneurs' relief purposes is preserved.

2. Transfer of shares in TradeCo from BVI HoldCo to UKCo

The next step is to transfer the shares in TradeCo from BVI HoldCo to UKCo. Although this is prima facie a straight-forward transaction, it raises a significant number of tax issues.

If we first assume that BVI HoldCo is solely tax resident in the BVI, this is a disposal of shares by a close overseas company controlled by two UK shareholders. Under TCGA 1992 s 13, the gain which would otherwise arise on the disposal can be apportioned back to the two shareholders. TCGA 1992 s 14 sets aside this charge where the transfer arises between two members of an overseas group. However, as UKCo is UK tax resident, no protection is afforded by this section.

The alternative is to rely on the substantial shareholding exemption at TCGA 1992 Sch 7AC. The relief applies because the following conditions are met:

- BVI HoldCo is (at the time of the transfer) the holding company of a trading group;
- TradeCo is a trading company; and
- immediately after the transfer, BVI HoldCo is a member of a trading group. (For these purposes a group includes overseas companies.)

It is however possible that BVI HoldCo is also UK resident if it is 'centrally managed and controlled' in the UK. This is likely to be the case if the two shareholder-directors exercise ultimate control of the business from this country, primarily through the holding of Board meetings here. In such circumstances, the BVI HoldCo is likely to be considered dual resident. This is because there is no treaty between the UK and the BVI which would otherwise award residency to one or the other.

If BVI HoldCo is UK resident, or made UK resident by deliberately moving its central management and control here, then TCGA 1992 s 171 would apply to treat the transfer of shares from BVI HoldCo to UKCo as occurring on a no gain/no loss basis. The potential dual resident status of BVI HoldCo does not impinge on this analysis.

The question is then what should the consideration be for the above transfer?

The shares could be transferred for nominal value so as to strip value out of the now defunct BVI HoldCo, or book value or market value. However, the transfer of the shares at undervalue could be deemed to be a distribution by BVI HoldCo under CTA 2010 s 1000 and as the BVI HoldCo is resident in a tax haven any such distribution receivable by UKCo would be a taxable receipt in the hands of the latter.

It is therefore preferable for the shares in TradeCo to be transferred at market value. Such a transfer is prima facie subject to stamp duty at a rate of 0.5% but relief should be available under section 42 Finance Act 1930 on this intra-group transfer.

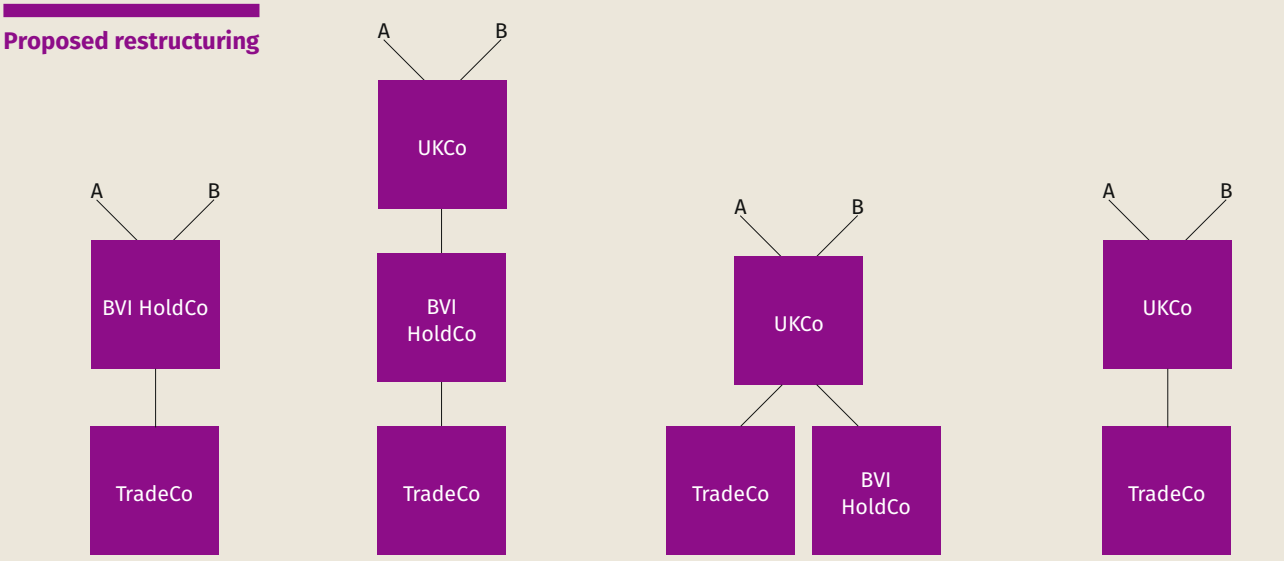
As set out in *Statement of Practice SP3/98*, HMRC scrutinise such claims carefully where the consideration is left outstanding on loan account. This is because HMRC consider that this may be planning designed to reduce the value of the transferee ie UKCo for sale outside the group.

In this case, the transfer does not diminish the value of UKCo, nor is there any imminent plan to sell UKCo so group relief should be permitted, although given the rate of stamp duty, the level of exposure is low.

The base cost of the shares in the shares of TradeCo to UKCo will then be their original cost to BVI HoldCo (under s 171).

By contrast, if BVI HoldCo is not made UK tax resident, s 171 is set aside and the shares will instead be deemed to be acquired at market value. There would thus be a step up in their base cost but assuming that the substantial shareholding exemption would apply to any future sale of TradeCo by UKCo, then this is unlikely to have any practical benefit.

Proposed restructuring



3. Removing BVI HoldCo from the group structure

As set out above, any dividend paid by BVI HoldCo to UKCo will be taxable in the hands of the latter so we therefore recommend that BVI HoldCo is liquidated under BVI law.

The return of value to UKCo will be a capital receipt. However, the base cost of the shares in BVI HoldCo will have been uplifted to market value at the time of the share for share exchange. Thus provided that there is no delay in the transfer of the TradeCo shares to UKCo (during which there could be an increase in value of the former) then no capital gain will arise on the liquidation of BVI HoldCo.

This will leave TradeCo as a wholly owned subsidiary of UKCo in turn under the control of the original shareholders.

If the above steps are followed carefully, this reorganisation can be undertaken tax-free. Furthermore, if a holding company is not required, it should be possible to hive up the trade and assets of TradeCo to UKCo on a tax free basis so as to further simply the structure. ■