



Individual Reorganisation

As business grows, the existing business structure that is being used may no longer be appropriate and there may be a need to restructure.

A corporation may undergo restructuring or re-organisation for various strategic reasons such as merger, consolidation, corporate divisions, asset or share acquisition or to meet changing regulatory requirements.

Reorganisation has become a widely discussed topic in Fiji leading to the question of how entities involved in reorganisation transactions, as well as their shareholders, should be taxed for the transfer of assets amongst the transferor individual and company with the transferee and transferee companies.

Prior to August 1st 2020, Section 88 of the Income Tax Act (ITA) 2015 was only applicable to corporate reorganization disposals. However, from 1st August 2020, the scope of section 88 has been widened to include transactions between a resident individual or individuals to a transferee company which is wholly owned by the resident individual or individuals.

This week's Tax Talk focuses on Individual Reorganisation while we will be covering Corporate Reorganisation will be covered in next week's Tax Talk.

Individual Reorganisation

From August 1st 2020, Section 88 of the Income Tax Act 2015 provides that the deferral rules for individual reorganization are met when the following conditions are met:

- a) a resident individual disposes of an asset to a resident company; and
- b) the transferee (recipient) resident company is wholly owned by the resident individual.

To qualify for deferral under individual reorganisation, the Fiji Revenue and Customs Service (FRCS) will consider the following factors:

1. Consideration

- For the transfer of an asset, the consideration should not exceed its cost (inclusive of incidental and improvement cost)

- If an individual has acquired an asset for \$1000 (including incidental and improvement costs), the transfer to the transferee company must not exceed \$1000. The transfer may be at nil consideration but in order to qualify for the deferral, the transfer should not exceed the cost.
- For transfer of depreciable assets, the consideration should not exceed the written down value of the asset. This is to ensure that the depreciation deductions are not claimed repeatedly by the transferor and transferee on the same asset.
- If the disposal or transfer is for consideration exceeding the cost, the fair market value must be used for transactions between associates. The normal income tax rules would apply in such cases.

Deferral of Gain on disposal of asset.

A deferral of a gain on disposal of an asset provides that **no gain or loss** is recognised on the part of the supplier on the disposal but the gain is deferred to the recipient of the asset.

For example, A had purchased an asset for \$100 which has a current market value of \$500. The asset is transferred to B (a related party) at cost. Under normal rules, the transfer would be deemed to be provided at fair market value and A would have made a gain of \$400 (\$500 - \$100) and B would be deemed to have acquired the asset at \$500.

The transaction, if deferred would mean that B is treated to have acquired the asset for \$100 and not at the market value of \$500.

Furthermore, the asset is treated as having the same character in the hands of the transferee as it did in the hands of the transferor.

2. Resident Individual

An individual is a resident of Fiji if they satisfy the conditions under section 6 of the Income Tax Act 2015.

An individual is a resident individual if the individual:

- a) resides in Fiji;
- b) is domiciled in Fiji unless the individual has a permanent residence outside Fiji;
- c) is present in Fiji for a maximum of 183 days in any 12-month period; or
- d) is an employee of the Government posted in overseas

3. Resident Company

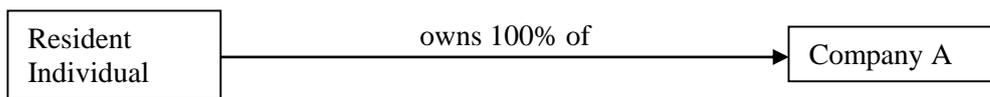
Section 88(4) of the Income Tax Act provides that a “company” for the purposes of the corporate re-organisation rules refers to incorporated bodies. Although “company” under its normal definition includes unincorporated bodies as well, the deferral rules are limited to where the transferee is an incorporated body only.

Transferee Resident Company to be wholly owned by the Resident Individual

In order to qualify for the deferral, it is required that the resident individual should wholly own the transferee resident company. This is achieved when 100% of the issued shares in the company is wholly owned by the transferor (individual) wither directly or through one more interposed persons.

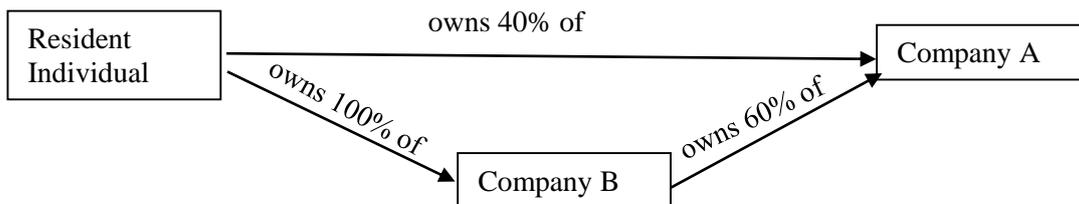
This is achieved through the following scenarios:

Direct Ownership



Resident Individual owns 100% of the shares in Company A

Indirect Ownership



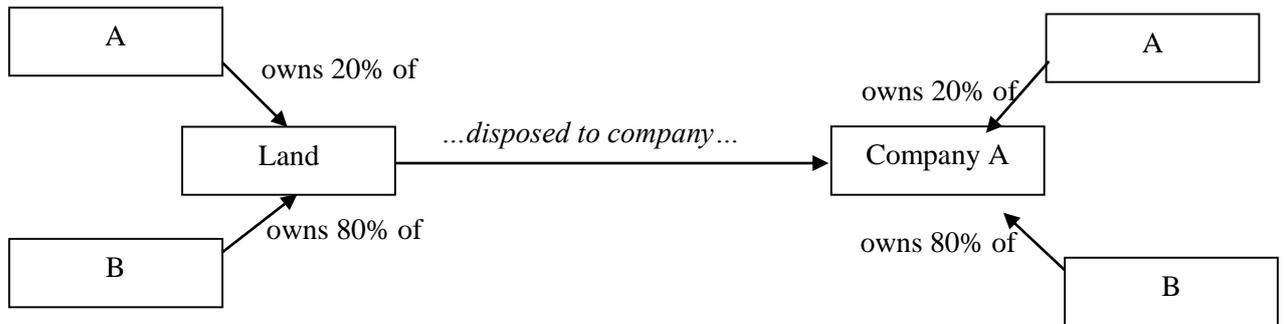
Resident Individual owns 40% of the shares in Company A directly and the remaining 60% is owned indirectly through an interposed person (Company B).

Collective or Joint disposal of an Asset

In the event that there is a collective disposal of an asset between resident co-owners of an asset, it is required that the percentage of ownership in the asset or the depreciable asset should be the same as their percentage of beneficial ownership of the issued shares in the transferee.

For example, individual A and individual B own a piece of land on a 20% and 80% basis respectively. In order to qualify for the deferral under section 88 of the ITA 2015, individual A should own 20% of the issued shares in the transferee company while individual B should own 80% of the issued shares.

That is:



The deferral rules will not apply if a joint owner of an asset is disposing their ownership or interest in an asset. That is, in the above example, the deferral rule will not apply if only individual A disposes his 20% share of the land to the company. The co-owners of the asset must collectively transfer the asset to the transferee company.

4. Changes of Ownership in the Transferee Company

As highlighted above, the deferral rules under section 88 recognise that there is no change in economic ownership where an asset is disposed by a resident individual to a transferee company if the company is wholly owned by the individual.

In this regard, if there is a change in ownership or shareholding in the company, the change translates to a change in economic ownership of the asset which was the subject of the disposal.

Therefore, if there is a change in shareholding of the transferee company within two years from the date of disposal, any taxes applicable at the time of disposal shall immediately become payable.

For example; individual C and individual D have joint ownership of a manufacturing equipment on a 40%:60% basis, which they intend to transfer to their company. Their shareholding in the company is on a 40%:60% basis as well. The transfer of the equipment qualifies for the deferral under section 88 and the same is transferred on 1st September 2020. If the disposal would not have qualified for the deferral, the joint owners would have paid capital gains tax of \$15,000.

Six months following the disposal, on 1st March 2021, the company issues new shares and welcomes individual E as a shareholder where individual E now owns 10% of the company and individual C and individual D own the remaining shares on a 36%:54% basis.

With the change in shareholding, the economic ownership of the equipment changes as well. Therefore, the capital gains tax of \$15,000 which was payable by individual C and individual D on 1st September 2020 immediately becomes payable by individual C and individual D on 1st March 2021.

A change in ownership may be realized in the following scenarios:

- a. Entry of new shareholders;
- b. Exit of an existing shareholder; or
- c. Change in ownership of shares between existing shareholders.

If the change in ownership occurs after the two-year period from the date of disposal, then there is no reversal of the deferral implications applicable initially.

You may also refer to the Standard Interpretation Guidelines (SIG) 2020-26 <https://www.frcs.org.fj/wp-content/uploads/2020/08/SIG-2020-32-Re-organisation-Section-88-of-ITA-2015.pdf> for further details on Reorganisation.

For more information and feedback please email us on info@frcs.org.fj.

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