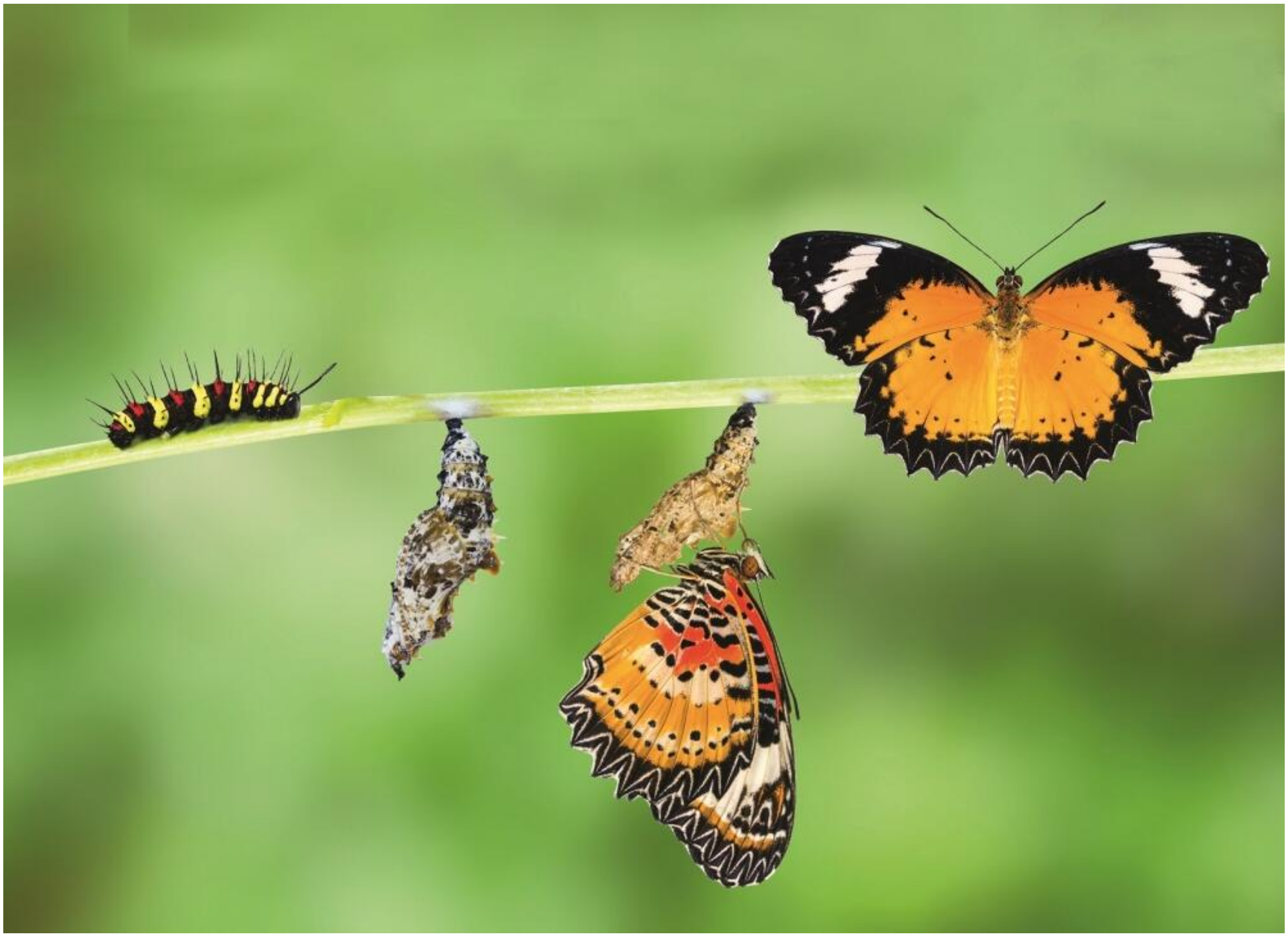
The business lifecycle

OMB



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Paul Morton and *Andy Richens* provide an overview of the OTS report on the business lifecycle and discuss their recommendations

Key Points

What is the issue?

The UK economy relies on the lifeblood of business, and the OTS wants to understand how tax helps or hinders across the lifecycle, from formation, through growth and funding, to succession or sale.

What does it mean to me?

A number of reliefs apply at various stages of the business lifecycle, but many businesses are unaware of their existence, with complexities deterring many from making a claim.

What can I take away?

The OTS is interested in hearing views how this work may be carried forward, and which areas should be prioritised.

Background

The Office of Tax Simplification (OTS) is the independent adviser to the Chancellor on ways of simplifying the tax system. Decisions are made by Ministers and implementation is for HM Treasury and HMRC and our role is only to advise, but our recommendations can be very helpful in informing the debate.

Our primary concern is with the ‘user experience’ of those who interact with the tax system, including people who start and grow a business and who will eventually either sell the business or pass it on to the next generation. We are keen to ensure that the ‘user experience’ is as simple as possible so that as much time and effort as possible is spent on running the business rather than tax administration!

From the time of the very first OTS project, the review of tax reliefs published in 2011, stakeholders have informed us of various complexities regarding business asset reliefs. In 2014 the OTS Competitiveness review looked at the World Bank’s Doing Business report, and made a number of recommendations to improve the UK’s already competitive tax system.

Last summer, the government launched a consultation on options to help innovative UK businesses access patient capital, i.e. long term investment, and the Autumn 2017 budget announced changes to some of the venture capital reliefs with a view to better targeting towards innovative firms.

Alongside this, at a time when the UK economy relies on the lifeblood of businesses, the OTS wanted to look at the ways tax helps or hinders businesses across their whole lifecycle, from formation, through growth and access to funding, and onto succession or sale. This was an informal paper rather than a formal review requested by the Chancellor.

The OTS met around 20 business advisers and representative organisations, as well as HM Treasury and HMRC teams.

Work began in summer 2017 and the OTS published its paper on 16 April. As with all OTS reviews, the simplification observations are a mix of technical matters on the tax system itself, and the way in which it is administered.

Reliefs: general

Successive governments have supported business through a range of reliefs intended to encourage innovation and investment. However feedback showed that some businesses were simply unaware of their existence, or found them to be overly complex in understanding how they may apply.

Start of the business

A key observation was that while there are a number of tax reliefs, such as the enterprise investment scheme, applying for those who invest in business, there are no such reliefs for the founders themselves, nor indeed for relatives and friends investing at the time of starting up.

The OTS Small Company report looked at the choice of business medium, whether sole trader, partnership or limited company. Drawing on an IPSOS Mori study and our own survey, the conclusion was that limited liability, while by no means the only factor, was a primary consideration in deciding to operate through a limited company. The introduction of the dividend tax in April 2016 has, of course, reduced the significance of taxation in deciding which medium to use. When incorporating, the OTS would like a seamless one-stop shop process for registering the company at Companies House, and for HMRC taxes. Applying this for both the gov.uk web incorporation service, and for users of third party software, together with a streamlined accounts filing service, would reduce an admin burden faced by business.

Financing

It was clear the test of 5% ownership of a company’s share capital to qualify for entrepreneurs relief (ER) could act as a disincentive for founder shareholders to bring in external venture capital, and the consultation announced at Spring statement 2018 on allowing ER on gains following dilution in this way is very welcome.

The enterprise investment scheme (EIS), and the seed enterprise investment scheme (SEIS) have proved popular, but the OTS has also heard that a good number of smaller businesses are completely unaware of the schemes. A number of complexities are built into the legislation which can catch out businesses, resulting in relief being denied, or even withdrawn some time after the investors have made their investment. The OTS would like to see a review of these rules with a view to remove unnecessary complexities.

The three venture capital schemes, EIS, SEIS and venture capital trusts (VCTs) have a number of different rules meaning they tend to attract different types of investors – it is unclear whether these are consistent with the future needs of the business itself.

The OTS heard that there was room for improvement in administration processes in authorising the companies for EIS and SEIS and granting the relief for investors. We also heard of long delays in receiving a response to the advance assurance service. A consultation was launched in December 2016, with a published response document explaining that HMRC will keep the advance assurance process, but not respond where the application is clearly part of a capital preservation arrangement. Continued improvements in guidance, together with digitisation and relaxation of legislative inflexibilities could also contribute to improving the administration.

Succession

Passing on a trading business or shares in a trading company can be effected with no immediate tax liability provided conditions for CGT gift relief and IHT business property relief are satisfied. On entering a CGT gift relief joint claim, there is no immediate tax charge, but should the recipient dispose of the business within a year, tax at the full 20% rate may be due from the recipient. Alternatively, a claim to ER at the point of the gift would result in the reduced rate of 10%. These two reliefs are mutually exclusive, but deciding which to claim depends on knowing the future plans of the recipient – simplification of the interaction of these reliefs would be beneficial here.

Whilst the definition of ‘trading’ company for the purpose of CGT gift relief and ER are the same, restricting the non-trading element to 20% of the whole, IHT BPR uses a different definition, based on being not wholly or mainly (50%) investment. These tests mean that in certain cases a business may qualify for one form of relief but not another, which is a cause of confusion for businesses. Notably, furnished holiday lettings has a favoured trading status for CGT reliefs, but not so for IHT.

Disposal

The OTS wonders whether ER is fulfilling its title, in encouraging investment in young and growing business, and may warrant a closer review. One technical point was raised with us, that relief is only available in respect of additional contingent consideration received at a later point, by electing for a value to be taxed at the point of sale, but this would result in a dry tax charge. The unascertainable consideration principle was established in the 1980 case of Marren v Ingles. This can influence the business owner to sell for cash when a sale with consideration tied to future business performance may have been a better structure. Simplification of treatment could remove this business distortion.

Advisers will be aware of the alternative disposal methods of selling the assets of the company, or selling the shares in the company. A tension can exist between vendor, who would encounter a double tax charge under the asset route, and the purchaser, who is likely to prefer the asset route through their own fresh company rather than the potential risks of purchasing the existing company. Could aligning tax treatments help reduce these difficulties?

On winding up a company, either where the assets have been sold as above, or the business has simply ceased, the FA 2016 targeted anti-avoidance rule on distributions can result in an income tax rather than capital gains tax charge. There is no clearance procedure, and we were told that the HMRC guidance is unclear about when the charge applies. Further guidance, with examples, will help give businesses the certainty they need.

Conclusion

It is clear that although tax reliefs do exist at the various stages of the business lifecycle, they may be unknown to the businesses they are intended to support, with complexities deterring some from making a claim. With the time now ripe for encouraging innovation and supporting growing companies, the OTS calls for further detailed work on the above stages, to help business maximise these opportunities.

We would be very interested in hearing views from readers. How do you feel this work might be carried forward? Are there particular areas which you feel should be prioritised? We also wonder whether there is more that advisers could do in bringing the various reliefs to the attention of business owners. In particular, it would be beneficial if more businesses were aware of the reliefs for raising venture capital. We are currently planning how best to continue our work in this area so readers' comments will be helpful in informing the way forward.

The summary of the OTS's Business Lifestyle report was first published in Tax Journal and is reproduced here with permission.