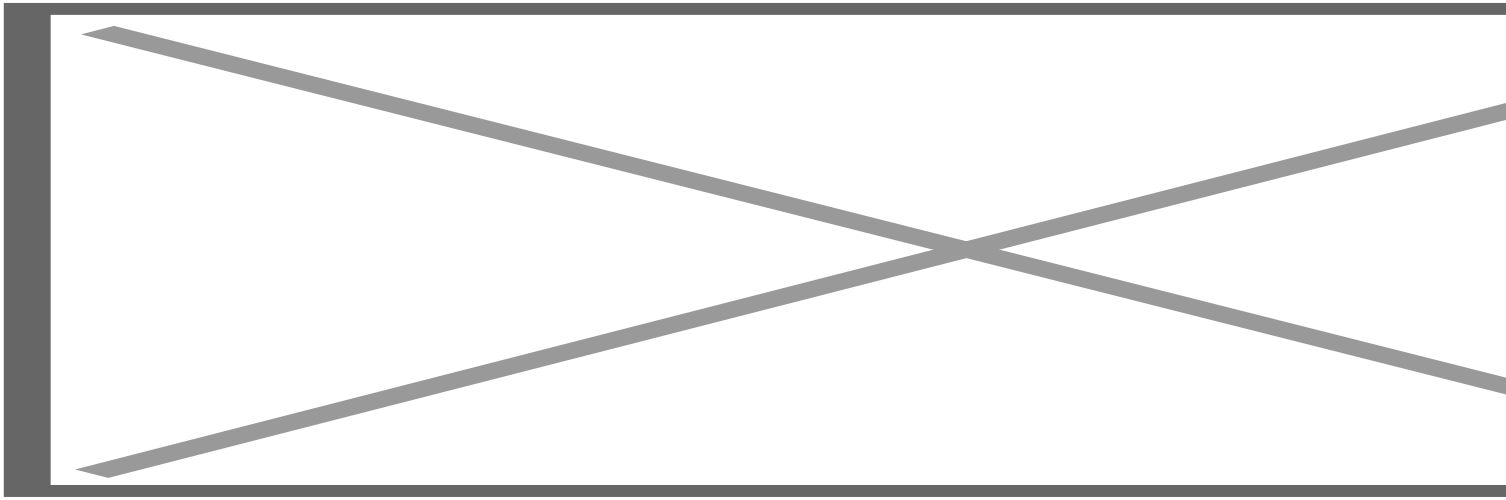


Entrepreneurs' Relief: Choppy waters

Personal tax

Tax voice



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Kevin Slevin guides us through some key issues

It is some eight years since the government announced the intended introduction of CGT Entrepreneurs' Relief ('ER'). Little did we know how important a relief it would become. Although only worth a maximum of £80,000 to any one businessman for its first year of operation the maximum level of ER available to a single claimant in 2015/16 is £1,800,000! Arguably, it is the most talked about tax relief affecting the business community. Strangely, a taxpayer need not demonstrate that he or she is properly to be regarded as an entrepreneur in order to make a claim. For example, a properly advised owner of an asset-based business acquired by him by way of an inheritance may well be in a position to claim ER, i.e. should he run the business for at least a year before realising chargeable gains on disposing of selected assets.

One inevitable outcome of the increase in the level of relief is that we have seen an upsurge in the level of resources HMRC is prepared to devote to enquiring into claims made and challenging those which may appear doubtful. With part of the legislation being taken directly from the old retirement relief provisions (abolished with effect from 6 April 2003) it is not surprising that many of the contentious issues relating to retirement relief apply equally today; the main difference being that the number of claimants to retirement relief was small when compared to the number of claims to ER. It is not surprising therefore that the number of enquiries into ER claims rises as each year goes by.

Tax Voice readers will understand the fundamentals of the ER legislation found in Sections 169H to 169V and so in this short article I am seeking to highlight some of the trickier issues – the type of problem situations which can easily be overlooked in the hustle bustle of a practitioner's busy life.

Marriage Breakdown

Where a capital gain arises on the disposal of shares readers will know that one of the conditions the shareholder must satisfy is that throughout the one-year period ending with the share disposal date (or if earlier the date on which the company ceased to be a trading company), he was either an officer or employee of the company to which the shares relate or an officer or employee of a subsidiary of the company in which the shares were held. Many decisions may be made in the weeks immediately following the breakdown of a marriage or civil partnership and this is particularly so where the couple cannot face continuing to work together. ER is not likely to receive any consideration. The parties may not appreciate that if, say, the husband ceases to be an officer of the company and agrees to leave his wife to run the business which they own jointly, such a step may well prevent a claim to ER on a disposal at a later date. Say two years later a buyer is found for the entire share capital and a substantial capital gain arises. The likelihood is that the tax issues will only be properly considered shortly before the intended disposal and only then will it be discovered that while one spouse can claim entrepreneurs' relief and pay tax at 10% while the other is due to pay 28%. Timely consideration of such issues can save a substantial amount of CGT. This is likely to be important from the standpoint of both spouses because, in most instances involving a situation relating to a family business, the increase in the tax burden caused by the loss of ER will effectively be shared between the parties under the terms of the financial settlement. For example, in the case of an overall 50:50 division of wealth it will be the post-tax funds realised on a disposal which will be shared equally in arriving at the agreement in respect of the division of assets. Accordingly, if one spouse pays unnecessary tax due to the loss of entrepreneurs' relief this extra tax may effectively be shared between them.

Officer or employee

Believe it or not, almost the first thing HMRC check when deciding whether to enquire into a return containing an ER claim regarding a share disposal is whether or not the person can be seen to have been an officer or employee throughout the one-year period prior to the disposal date. In the case of an employee, officials will look at the PAYE records of the company as HMRC's view is that there cannot be an employment unless there is payment. This view is hotly contested. Interesting reading in this area are the First-tier Tribunal decisions in *Susan Corbett v HMRC* [2014] UKFTT 298(TC) and *Richard Hirst v HMRC* [2014] UKFTT 924 (TC). These appeals by taxpayers (both successful) not only demonstrate HMRC's keenness to take the points argued but also show just how the individual facts of each case have to be fully explored. The position of officers working in a company is more clear (and payment of remuneration is not a requirement, simply to be an office holder is all that is required). Either the claimant can demonstrate that he is a director or he or she has been its company secretary. Such positions are a matter of public record and HMRC's starting point will examine the Company House records. However it should be noted as regards modern companies whose constitution may not require there to be a company secretary, that such situations can be problematic in this regard. If a person has been using the title 'company secretary' but, formally speaking, there is no such office of the particular company exists, arguably the person is not an 'office holder'. Only if he or she were paid to carry out the duties performed could such a person be certain of meeting the 'officer or employee' test in the eyes of HMRC. While there is nothing to prevent such a company resolving to create the office of company secretary, it will be appreciated that this cannot be done retrospectively and, therefore, if the individual cannot be said to have been a paid worker for the company throughout the appropriate one-year period, the newly created office of company secretary would need to be held for at least one year before ER qualification would be met in this regard.

Part of a business?

Another area which frequently gives rise to concern in relation to unincorporated businesses concerns disposal where part of the business continues to be carried on by the taxpayer. This is an area where it is often difficult to

give clear advice because it is not easy to know how HMRC officials will interpret the facts. One First-tier Tribunal decision which highlights HMRC's interest in this area is that of *M Gilbert t/a United Foods* [2011] UKFTT TC 01542. Here HMRC cited six retirement relief cases (including the well-known *McGregor (HMIT) v Adcock* 51 TC 692) and sought to demonstrate that the disposal was that of an isolated asset disposal and did not comprise a disposal of part of a business as required by Section 169I(2)(a). Mr Gilbert represented himself with great ability and his appeal was successful. Interestingly, the judge found that it was appropriate to look at the buyer's position to assist in establishing the position. In short, if the buyer was acquiring something more than a single asset or a bundle of assets such that what was being acquired was a business in the eyes of the acquiring party, this would be indicative of the fact that the vendor had indeed disposed of part of his business.

Cessation: What Cessation?

In the case of *Jeremy Rice v HMRC* [2014] UKFTT TC0133 the taxpayer had claimed relief based upon Section 169I(2)(b), i.e. the gain arose on a disposal of an asset which (a) had been in use for the purposes of his business at the time his business was discontinued and (b) was disposed within the three-year post-cessation window laid down in Section 169I(4). To the taxpayer's surprise officials argued that he had not actually ceased to trade. HMRC did not dispute that he had ceased to carry on the trade of second-hand car dealer (and repairer) from the premises disposed of (a business conducted by him as a sole trader) but officials asserted that he was merely carrying on the same trade from a different location. Yes there had been an interval where no trading of any kind took place but HMRC argued essentially that a second-hand car dealer was a second-hand car dealer from wherever he operated in the locality. The Tribunal took a more objective approach to the facts and accepted that the activity carried on from the former business premises on a commercial estate was a separate trade from that later carried on from his home address – not least because his *modus operandi* had clearly changed (in particular he was now selling exclusively on-line and dealing in a specific category of vehicles).

It was further found in the *Jeremy Rice* case that the disposal date in respect of the premises which he sold was indeed within the three-year window referred to above. HMRC officials argued that, if it was found that one trade had ceased and another had commenced, the facts of the case pointed to a cessation date of the initial trade which fell more than three years prior to the disposal date of the premises from which the trade had been conducted. This was considered by the Tribunal and it was held that the cessation of the old trade was less than three years earlier than the disposal date of the former business premises. Mr Rice was entitled to ER.

Tax Voice readers are encouraged to study the reports of the aforementioned two appeals so as to be clear as to the lengths HMRC will go in order to challenge an ER claim. It is their job to do so when all is said and done but in practice all too often advisers assume that ER will be due without first making sure that there are no possible counter arguments. Advisers should work on the basis that the facts could be challenged where there is a large amount of tax at stake. The strengths and weaknesses of their client's case should be identified and consideration given in advance of a transaction wherever possible to preparing for a challenge by HMRC.

Creative Thinking

Sometimes a taxpayer sets out to bring about a situation whereby an asset disposal, which is being planned to take place at least one year ahead, is to be brought within the ER provisions by creating a bespoke trade for the purpose. For example a residential property (say is located in London and likely to be sold at a substantial capital gain) may have been rented to the same tenant for twenty years and, as such, is clearly an investment asset. The capital gain will not attract ER on the basic facts. However, the taxpayer recognises that one of the peculiar features of ER is that it is possible to use a former investment asset in a trade for a period of just one year and to then cease the trade before disposing of the asset to a third party. The legislation focuses on individuals who

have been involved in running businesses and, even though the trading use of the asset last for only one year, if all the conditions are shown to have been met, it is possible to argue that the whole gain can attract entrepreneurs' relief after only one year of trading activity. Section 169I(2)(b) simply requires that there is a disposal of an asset which can be properly said to have been in use in the trade at the time that trade is ceased (and, as indicated earlier, that the disposal takes place before the third anniversary of the cessation date). In circumstances of a contrived trading activity (such as a period of letting within the furnished holiday letting rules or use of the property to provide bed and breakfast accommodation) officials can be expected to pay particular attention to the facts relating to the trade. One difficulty is that, for the purposes of entrepreneurs' relief, a business' means anything which:

- a) is a trade, profession or vocation, and
- b) is conducted on a commercial basis and with a view to the realisation of profits (section 169S).

Section 169S(5) states that 'trade' has the same meaning as in the Income Tax Acts, and it will be seen that section 989 ITA 2007 defines 'trade' as including any venture in the nature of a trade.

The obvious question is what does the expression 'conducted on a commercial basis' mean for these purposes? HMRC accept that 'commercial' is not the same as 'profitable'. In HMRC's manual paragraph BIM85705 it states 'We take it to mean, [a trade] conducted in the way that we would expect a business of the same type to be carried on. Furthermore, HMRC's manual goes on to state that:

'A distinction may also be drawn between individual transactions and the trade itself; individual transactions may have the character of commerciality but overall the way in which the trade is conducted may lack commerciality. Indeed, even where the trader is serious about what he does but does not act in the way someone in that type of trade would act, we take the view that the trade is not being conducted on a commercial basis.'

Contrived trading activity must stand up to close scrutiny.

In the HMRC's press releases which accompanied the Chancellor's Autumn Statement it was acknowledged that a further of the FA 2015 changes to ER was underway. This is understood to have made good progress and a further announcement is expected on March 16th.