Finance Bill 2016 cl 73–75 – entrepreneurs’ relief

OMB

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The CIOT/ICAEW-led stakeholder group considers the Finance Bill 2016 entrepreneurs’ relief clauses and recommends some amendments.

As readers will be aware, FB 2016 includes draft legislation to amend the unintended consequences of the Finance Act 2015 changes to entrepreneurs’ relief (ER). The CIOT and the ICAEW have led stakeholder engagement with HMRC in considering the detailed technical changes needed to reverse the unintended consequences of the changes.

The stakeholder group has continued its engagement with HMRC after publication of the draft clauses. Some of the issues raised with HMRC are detailed below.

Clause 73 – entrepreneurs’ relief: associated disposals

The changes in FA 2015 limited the availability of relief on a disposal of personal assets used in a business (‘associated disposals’) when the business was sold to members of the claimant’s family under normal succession arrangements.

Clause 73 allows ER to be claimed in some circumstances even if the 2015 changes prohibited it, recognising that these situations were not abusive.

The amendments will be backdated to the date on which the FA 2015 measures became effective. They will therefore apply to disposals on or after 18 March 2015.

Section 169K of the Taxation of Chargeable Gains Act 1992 (which this clause amends) requires that a claimant disposes of at least 5% of the partnership assets or 5% of the ordinary shares of a company. Further, relief is denied when arrangements allow the acquisition of shares or increased partnership share by anyone connected with the claimant (‘P’ in the legislation). The amendments in the Bill ensure that the disposal does not have to be a minimum of 5% as long as the claimant is disposing of all of his or her residual interest in the partnership or shareholding (new condition ZA1). This welcome relaxation allows for a gradual withdrawal from a business (a common situation in those that are family-owned) while retaining the ability to claim the relief.

There are some aspects of the revisions that the stakeholder group consider to have a potentially adverse retroactive effect. It is understood that such an effect is not within the policy intent and that the government is considering amendments.

The concerns are detailed below.

To satisfy new condition ZA1, the claimant must have held at least a 5% interest in the partnership assets for a continuous period of at least three years in the eight years ending with the date of the disposal and there are no partnership purchase arrangements (as defined) at the date of the disposal.

However, new condition D, inserted by cl 73 (11), requires that P has owned the asset that constitutes the associated disposal for at least three years at the date of disposal. As currently drafted, this condition applies to all associated disposals, not just to those whose material disposal was of the whole of a partnership interest of less than 5% (new condition ZA1). Applying condition D to all associated disposals has a potentially retroactive effect on claims for ER made for associated disposals from 18 March 2015 to the date of publication of the Finance Bill because it retroactively imposes the three-year period of ownership where no such requirement existed at the time of the disposal. The stakeholder group has therefore suggested that condition D is amended to limit its application to condition ZA1. In addition, condition D (either in its current or an amended form) should apply to disposals after the Bill was published because a claimant could not have known of that new requirement before then.

A further suggested change is to reverse the amendment made to condition A1 by cl 74(4), which now applies only to a disposal of part of P’s interest in the business, whereas it applied previously to the whole or part of P’s interest. If a claimant disposes of an entire interest of more than 5%, condition A1 will not be satisfied, so they must satisfy condition ZA1 instead, including the three-out-of-eight-years requirement. This is the case even though disposing of an interest of more than 5% after 18 March 2015 would have satisfied condition A1 without the need for this further condition.

The retroactive application of these amendments could now deny relief for a transaction made after 18 April 2015 based on the legislation in force. It is suggested that ‘the whole or’ is restored in s 169K(1A).

Clause 74 – entrepreneurs’ relief: disposal of goodwill

FA 2015 introduced rules to deny ER on the gain when goodwill is disposed of to a company that is related to the selling individual. This change also resulted in relief not being due to a person selling their business to a close company in which they, or a member of their family, held any shares – however small the holding – as part of a normal family succession.

FB 2016 cl 74 provides for a gain on goodwill to be eligible for ER if the claimant holds less than 5% of the shares and less than 5% of the voting power in the acquiring company. Relief will also be due if the claimant holds 5% or more of the shares or voting power should the transfer of the business to the company be part of arrangements for the company to be sold to a new, independent owner.

These helpful changes come into effect for disposals of goodwill on or after 3 December 2014.

A minor amendment was suggested by the stakeholder group. It is not entirely clear why new s 169LA(1)(aa) is framed as two separate conditions. It would be sensible to align the test directly to the usual ER test – in other words, 5% or more of the ordinary share capital *and* (rather than or) 5% of the votes by virtue of that holding.

Clause 75 and Sch 13 – entrepreneurs’ relief: ‘trading company’ and ‘trading group’

FA 2015 changed the definitions of ‘trading company’ and ‘trading group’ for the purposes of ER to prevent perceived abuse by the use of joint ventures or partnership arrangements. Particularly targeted are ‘manco’ structures, whereby members of a management team that would not have 5% interests in a trading company would instead form a management company of which they hold more than 5% interest. Then they would form a joint venture or partnership with the owners of the main trading company. However, the amendments affected all commercial joint ventures and corporate partnerships as well as those set up solely to achieve the 5% shareholding for ER purposes.

Clause 75 introduces Sch 13, which amends the meaning of ‘trading company’ and ‘trading group’ to allow a fraction of the activities of a joint venture company to be treated as carried on by a company that holds shares in it. Similarly, if the new definitions apply, trading activities of a company in its capacity as a partner in a firm will be taken into account in deciding whether the company is a trading company for ER purposes. The new definition of ‘trading company’ takes into account each claimant’s holding in the company on whose shares the gain accrues and in the joint venture or partnership. In other words, a company may be a trading company for the purposes of one claimant’s disposal but not for the purposes of another who disposes of shares in the same company at the same time.

The new definitions apply to disposals of shares on or after 18 March 2015.

One area of uncertainty is how these rules interact with those governing mixed partnerships in Income Tax (Trading and Other Income) Act (ITTOIA) 2005 ss 850C-850E. Broadly, these rules ensure that where profits allocated to a corporate partner can be enjoyed by individual partners, these must be reallocated to the individuals for income tax purposes. Partnerships may wish to revise their profit sharing arrangements so that only amounts of profit that will not need to be reallocated to individual members are allocated to the corporate partner in the first instance. This would prevent the need to make the reallocations and to make subsequent payments (covered by s 850E) to fund the individual’s tax charge and to equalise the position. However, the necessity for the corporate partner to have a sufficient interest in the income profits of the partnership for ER purposes could act as a deterrent or taxpayers might unwittingly fall foul of the ER rules while trying to best comply with those for mixed membership.