Draft FB 2015: restriction of reliefs on disposal of goodwill to related companies

Technical

01 March 2015

The CIOT has commented on the draft Finance Bill 2015 clauses on the denial of entrepreneurs' relief (ER) for disposals of goodwill to related companies and restricting corporation tax relief for internally generated goodwill transfers between related parties on incorporation.

The incorporation of a business will invariably be a commercial decision, albeit the tax consequences of incorporation will always be considered when doing so. In our view, a fair tax system should confer no special benefits where the same business continues to be owned and run by the same people but within a different legal structure. At the same time, there should not be any tax cost to incorporating a business that could impede a sensible business decision.

It appears that the new provisions could inhibit some commercial transactions because they will apply whether or not the shareholders of the company are identical to the owners of the previous unincorporated business.

We are aware of a case, for example, in which a five-partner firm was considering incorporating but two of them wished to exit and be paid out. Our reading of the draft legislation suggests that none of the partners, including the two exiting, will be able to claim ER on the disposal of goodwill. They will be treated as related parties of the new limited company by virtue of being associates of the other partners who will become shareholders in the new company (new TCGA 1992 s 169LA(2)). This seems unreasonable given that they will no longer have any stake in the business.

There would seem to be no policy reason why the changes should apply even where the company and the unincorporated business are not under the same economic ownership. It also appears that the widely drafted anti-avoidance provisions in new TCGA 1992 s 169LA(5) and new CTA 2009 s 849B(9) may prevent arrangements being put in place to enable, for example, the departing partners in the above example to claim ER. We do not think that this situation fits into the apparent policy intention and have asked for clarification on whether it is intended that the legislation should operate in this way. In our view the draft legislation should be amended to make it clear that exiting partners may claim ER.

New CTA 2009 s 849D(3) provides that any debits (losses) brought into account under Chapter 4 (Intangible Fixed Assets) in respect of the realisation of relevant assets, including goodwill, are non-trading debits. HMRC say that this is to limit how a debit arising on a subsequent realisation of a relevant transfer can be relieved. We think that this proposal is punitive because it is unlikely that many companies will be able to obtain full relief for the non-trading debits. It seems to us that a more sensible approach would be to exclude the goodwill from CTA 2009 Pt 8 completely, so a subsequent disposal would fall into the normal rules for corporation tax on chargeable gains. This would simplify the new rules and make them easier to operate.

In our opinion, this is also a missed opportunity to address the definition of 'goodwill'. We can foresee that the changes, particularly the denial of ER on disposals of goodwill to a related company, will lead to arguments about what is and what is not goodwill.

Finally, we point out that these changes were announced at autumn statement with immediate effect without any prior consultation. We firmly believe that, in general, proposed changes in tax legislation benefit from being exposed to proper advance scrutiny. The Tax Consultation Framework states: ‘The best public engagement allows the government to explore, develop and test new ideas to improve the tax system and to ensure that change is well targeted and its likely impacts are understood.’ Over-hasty policy decisions can lead to unfairness and unintended consequences, and risk undermining the consultation process.

The CIOT’s response can be viewed here www.tinyurl.com/pyxrfc6