CAPITAL GAINS TAX VOICE

Issue 01 – March 2016
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CHAIR’S VIEW

As our members are well aware, this has been a busy few months for those whose practice areas cover non-residents, non-domiciliaries or trusts.

Despite giving assurances in the light of 2008 changes to the remittance basis that there would be no further substantial changes to the taxation of non-domiciliaries, there have been significant proposals for change in that field.

The most recent of these, and which has kept the Committee very busy, relates to the introduction of a deemed domicile concept for the purposes of all taxes together with proposals to remove excluded property status of UK situate residential property held through offshore structures. This is dealt with by John Barnett later in this edition and I shall not stray into the details of the proposals here. However, it is worth noting the process by which these proposals are being progressed: rather than being handed a fait accompli, these proposals have been the subject of extensive informal consultations between the Government (HM Treasury and HMRC) and the representative bodies. There has been constructive dialogue on issues ranging from the overall shape that the proposals may take (it being made clear that the policy underlying the proposals was not up for discussion) to the more detailed discussions on the need for precise and non-ambiguous statutory language to achieve the desired outcome. This level of engagement on the part of HM Treasury and HMRC is very welcome. It is hoped that it will in the near future produce draft legislation dealing with all aspects of the proposals so that the CIOT can not only provide constructive input on the drafting but so that it can identify any areas which are not, or not adequately, covered by the draft legislation.

Another area of ongoing interest is the saga of HMRC’s change of position on debt collateral and the remittance basis. Members will recall that Manual RDRM33170 had indicated that certain uses of relevant foreign income and foreign chargeable gains (”FIGs”) would not amount to a taxable remittance of those FIGs. In August 2014, HMRC changed their position and required structures that were affected to unwind within approximately 20 months.

This committee was closely involved in seeking to clarify the many areas of concern arising from this abrupt change of position by HMRC – not least whether any grandfathering of structures set up in reliance on HMRC’s previously stated position...
would be available. Ongoing dialogue, via correspondence and meetings, finally resulted in a statement published in November 2015. As members will be aware, this does not address all the concerns and leaves, inter alia, the position of revolving loans and superfluous security unresolved. This committee has continued to liaise with HMRC to resolve the outstanding issues.

This is sadly not the only area in which an unheralded and abrupt change of HMRC position remains unresolved. Members may be wondering what is HMRC’s current position in relation to specialty debts. The committee met with HMRC in late 2015 to press for progress in this area. Members will be heartened to hear that HMRC were receptive to the committee’s comments. For example, it was emphasised that there was no warrant to introduce a test for situs of a speciality debt which was based solely or largely on the location of the debtor. Further, HMRC were made aware that the impact of the issue of situs of a specialty debt was not limited to the inheritance tax context but extended to the remittance basis as well. There is, we are assured, renewed interest within HMRC in ensuring that this issue is clarified. The likelihood is that this clarification may well form part of the inheritance tax / excluded property package of measures to be included in the Finance Bill 2017.

Aparna -Nathan
Chair, CGT&II Sub Committee
CGT AND RESIDENTIAL PROPERTIES?

Natalie Miller highlights the significant features of the ATED-related gains and NRCGT regimes

Background

There has been a raft of changes to the taxation of residential property in recent years. This article provides a comparison of two recent extensions to the capital gains tax charge arising on disposals of residential property, giving a high-level overview of these two new charging provisions.

Overview

The ATED (Annual Tax on Enveloped Dwellings) regime came into effect in 2013, with the necessary changes being made by the FA 2013. As it was primarily driven by the concern regarding SDLT avoidance, it falls within HMRC Stamp Taxes. The NRCGT (Non-Resident Capital Gains Tax) came into effect from April 2015 as a consequence of the concerns arising from the use of offshore ownership structures to mitigate UK taxation. Further changes it would appear (for example as regards IHT), are inevitable.

<table>
<thead>
<tr>
<th>ATED-related gains</th>
<th>NRCGT</th>
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</thead>
<tbody>
<tr>
<td><strong>Legislation</strong></td>
<td>Sch 4ZZA TCGA 1992</td>
</tr>
<tr>
<td><strong>In a nutshell</strong></td>
<td>Extension of capital gains tax charge to high value residential property which is held in a corporate envelope and is within the ATED regime. Any non ATED-related gain is taxable in normal way.</td>
</tr>
</tbody>
</table>
| **Aim**            | • Part of a suite of measures to deter the acquisition and ownership of UK residential property through a corporate envelope to ensure the “fair taxation of residential property transactions”.
• Applies to disposals on or after 6 April 2013. | • To address the perceived imbalance between UK and non-UK resident owners of UK residential property.
• Targeted at smaller non-UK resident persons with UK property rental and investments businesses.
• Applies to disposals on or after 6 April 2015. |
**Scope of the charge**

The residence status of the taxpayer is not relevant for the ATED charge and the CGT on ATED-related gains. There was some concern that the ATED would be a precursor to a broader "mansion" tax: the increase in the ATED charge by 50% above the rate of inflation (CPI) in 2015 and the progressive reduction in thresholds (from £2m to £1m in 2015 and to £500,000 in April 2016) highlights the scope for extending the reach of this charge.

<table>
<thead>
<tr>
<th>ATED-related gains</th>
<th>NRCGT</th>
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<tbody>
<tr>
<td><strong>On what?</strong></td>
<td>Gains accruing after 6 April 2015 on the disposal of an interest in UK residential property, however it has been used. Includes sale/grant of freeholds/leaseholds; grant of options to dispose of such property and right to acquire housing sold ‘off-plan’. - No de minimis. - All property included unless there is a specific exemption, such as those for care homes; children’s homes, student accommodation; prisons; hotels; land without housing. - Where there is a change of use, only the residential use element is subject to NRCGT. - Where a property is not habitable due to accidental damage, an exemption may be available.</td>
</tr>
<tr>
<td>Gains accruing after 6 April 2013 on property within the ATED regime, where there is: - A disposal of a chargeable interest; - In a property that has at any time been a single-dwelling interest; - Where the value exceeds the ATED threshold (£500k since 6 April 2016)</td>
<td></td>
</tr>
<tr>
<td><strong>On whom?</strong></td>
<td>Individuals; trustees (as a single body); personal representatives (PRs) (treated as a single body) and companies who are non-UK resident (broadly) when the disposal occurs. Special rules apply to groups of companies. - Automatic exemptions for investment trusts, venture capital trusts, charities and registered pension schemes. - Potential exemptions for widely held companies, certain life insurance companies and diversely held open investment companies. - Exemption must be claimed but may be disregarded under certain anti-avoidance provisions.</td>
</tr>
<tr>
<td>Non-natural persons (NNPs) within the scope of the ATED (whether or not they are UK resident); broadly companies, partnerships with a corporate partner and certain collective investment schemes. - Days when NNP not within ATED are discounted. - Excluded persons include individuals; trustees; and personal representatives. - Does not apply to indirect holding of property such as shareholdings in company which owns property. - Existing CGT exemptions continue to apply for authorised unit trusts, open-ended investment companies, investment trusts, venture capital trusts, charities; registered pension schemes and certain EEA collective investment schemes.</td>
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</tbody>
</table>
Inevitably, given the need to deal with commencement issues and record keeping, the computation of the taxable gain (or allowable loss) is complex.

<table>
<thead>
<tr>
<th>Calculating the gain</th>
<th>ATED-related gains</th>
<th>NRCGT</th>
</tr>
</thead>
</table>
| **Choice between:**  | - Default method: Rebas: Notional post-April 2013 gain/loss calculated as if acquired interest at open market value on 5-Apr-13 (or April 2015/2016 where property within £1m/£500k thresholds respectively).  
- Election option: Irrevocable use of a pre-Apr-13 value (31-Mar-82 or acquisition date if later) as base cost, rather than rebasing.  
- Useful where properties decreased in value between purchase and Apr-13. | - Default method: Sale proceeds less (open market value @ 5 April 2015 or acquisition cost if later + subsequent enhancement expenditure + legal costs).  
- Straight-line time apportionment: Sale proceeds less (acquisition cost +enhancement expenditure +legal costs); time-apportioned to determine post Apr-15 element. Cannot be used where it is a relevant high value disposal. Need to elect for this option (irrevocable).  
- Retrospective basis: Sale proceeds less (acquisition cost + enhancement expenditure +legal costs) – entire gain/loss. Need to elect for this option (irrevocable). |

| Calculating the gain - tapering | Form of ‘tapering relief’ whereby the ATED-related chargeable gain is restricted to an amount which is the lower of—  
- the full ATED-related gain and  
- 5/3 times the difference between the consideration for the disposal and the threshold amount for that disposal.  
Where only a proportion of the gain (the ‘relevant fraction’) is an ATED-related gain, the amount excluded from charge is reduced by the same proportion. | N/A |

| Calculating the gain – other points | To prevent the disposal of property in tranches, the threshold amount is reduced using a fraction of the disposal consideration divided by the total value of the disposed of interest + any part of the chargeable interest retained + any chargeable interest in the same dwelling owned in the six years prior to disposal. | N/A |
Losses, unsurprisingly are to be restricted.

<table>
<thead>
<tr>
<th>ATED-related gains</th>
<th>NRCGT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Losses</strong></td>
<td></td>
</tr>
<tr>
<td>Losses on ATED-related disposals:</td>
<td>Losses are ring-fenced – they can only be set against capital gains on similar property disposals by the same person in the future.</td>
</tr>
<tr>
<td>• Are restricted – if the disposal proceeds do not exceed the ATED threshold but the deductible amounts do. The disposal consideration will be treated as if it exceeds the threshold by £1.</td>
<td>However, if the owner subsequently becomes UK resident, the losses are then ‘unclogged’ and can be used in the normal way.</td>
</tr>
<tr>
<td>• Are ring-fenced – they can only be set against ATED-related gains of the same or subsequent tax years.</td>
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</tbody>
</table>

**Interaction**

There are a number of potential charging provisions and the need to consider the interaction has been met with detailed rules.

<table>
<thead>
<tr>
<th>Interaction with other charges / reliefs</th>
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<tbody>
<tr>
<td><strong>S13 TCGA 1992:</strong> Charge at the corporate level so attribution of gains to participators is not extended to the ATED-related CGT charge. However, non-ATED related gains could still come within s13.</td>
<td><strong>S222 TCGA 1992:</strong> Principal private residence relief may be available in tax years in which the 90-day test is satisfied.</td>
</tr>
<tr>
<td><strong>S171 TCGA 1992:</strong> General rule for transfers between group companies to be calculated as no gain / no loss disapplied where disposal subject to ATED.</td>
<td><strong>S10/s10B TCGA:</strong> NRCGT does not apply to gains already chargeable under these provisions.</td>
</tr>
<tr>
<td><strong>S161 TCGA 1992:</strong> ATED-related gains not within rollover election rules.</td>
<td><strong>S10A TCGA 1992:</strong> NRCGT takes precedence over temporary non-residence rules.</td>
</tr>
<tr>
<td><strong>Sch 7 FA15:</strong> ATED-related CGT takes precedence over NRCGT.</td>
<td><strong>Sch 4ZZA TCGA 1992:</strong> ATED-related CGT takes precedence over NRCGT. NRCGT applies only to gains not subject to ATED-related CGT.</td>
</tr>
<tr>
<td></td>
<td>Other CGT hold-over /roll-over reliefs may be available in specified circumstances.</td>
</tr>
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</table>

**Tax rate**

For ATED related gains the charge is relatively simple: for NRCGT, the situation is very complex. It was confirmed in the March 2016 Budget that the reduction in the general CGT rates would not apply to residential property.

<table>
<thead>
<tr>
<th>The rate of tax</th>
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<tbody>
<tr>
<td><strong>28%</strong></td>
<td><strong>20%</strong> for companies</td>
</tr>
<tr>
<td>Non-ATED related gains remain chargeable to lower corporation tax rates and subject to deduction for indexation relief.</td>
<td><strong>18% or 28% for individuals</strong></td>
</tr>
<tr>
<td></td>
<td><strong>28% for trusts and PRs</strong></td>
</tr>
</tbody>
</table>
Administration

The additional compliance burden is to be noted and, as reflected in the Autumn Statement proposal to extend the 30 day period for payment on account to all residential property transactions from April 2019, further changes can be expected.

<table>
<thead>
<tr>
<th>Reporting the gain</th>
<th>ATED-related CGT return (separate from both the ATED and self-assessment returns). Liability must be reported on or before 5 October following the end of the tax year in which the disposal occurred.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paying the tax</td>
<td>Currently tax due no later than 31 January following the end of the tax year in which the disposal occurred. Proposal for payment date within 30 days of disposal for CGT on all residential property disposals from April 2019</td>
</tr>
<tr>
<td></td>
<td>NRCGT return (separate from the self-assessment return) submitted electronically within 30 days of conveyance. Must include an advance self-assessment of liability. Finance Bill 2016 contains provisions confirming that an ATED-related return will not be required in certain circumstances.</td>
</tr>
<tr>
<td></td>
<td>Payment deadline within 30 days of conveyance. Those registered for UK self-assessment can elect to pay the CGT as part of their normal payment on 31 January following the end of the tax year. Proposal for payment date within 30 days of disposal for CGT on all residential property disposals from April 2019</td>
</tr>
</tbody>
</table>

Conclusion

Will probably not be long before the issue of CGT and residential property is on the agenda for the OTS!

Profile

Natalie Miller works for PwC in Norwich in their Tax Knowledge & Innovation Group where she specialises in personal tax and trusts. She is a Past President of the ATT and a current Member of both ATT and CIOT Councils. She is Vice-Chair of the CGT sub-committee. She can be contacted by email at natalie.a.miller@uk.pwc.com or telephone on 01603 883289.
ESC D33 IS TO BE NO MORE

Gillian Banks summarises recent changes to this important ESC and HMRC’s proposals to legislate it

Extra statutory concession D33 was published in 1988 following the judgment in Zim Properties Ltd v Proctor [58 TC 371]. Broadly the Court decided that the right to take court action for compensation or damages is an asset for capital gains tax purposes, often with little or no base cost, and the receipt of compensation is then a capital receipt that will be taxable.

Notwithstanding the wording in the concession HMRC considers that where there is an underlying asset, for example shares in a company or a building, the compensation is to be treated as derived from the asset, which is a purposive interpretation of the legislation rather than concessionary. This means that on receipt of compensation, there may be a part disposal of the asset (using part of the base cost), or for example if the receipt is used to repair or replace the property no gain or loss may arise.

The concession applies where there is no underlying chargeable asset – for example where losses have been incurred as a result of incorrect professional advice, private or domestic issues. In advance of the proposed consultation HMRC announced in January 2014 that in these cases the amount of compensation that would be exempt would be limited to £500,000. However, this is subject to HMRC review on a case by case basis for larger amounts to ensure they remain within HMRC’s collection and management powers. The clear implication was that relief on higher amounts would only be granted in exceptional cases. The CIOT and others responded to this unexpected announcement saying that the limit was arbitrary and could give rise to unfair results, two examples of which were included in response: http://www.tax.org.uk/file/140529-escd33-ciot-commentspdf.

A formal consultation was published by HMRC in July 2014 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/473989/Legislating_Extra_Statutory_Concession_D33_summary_of_responses.pdf. It proposed that the concessionary elements of ESC D33 would be legislated, and that an increased limit of £1million should replace the £500,000 in the concession as it presently stands. A summary of the responses was published in November 2015, and it is noteworthy that all of the respondents disagreed with the proposal to limit the exemption to £1million, as such a limit was considered to be arbitrary. Several disagreed with the principle of taxing such compensation at all.

Compensation that would typically be affected by a limit would be for some kind of financial loss. In the absence of a tax charge the Courts will normally order compensation, or its amount will be negotiated between the parties, to put the claimant in the same financial position as they would have been but for the fault. It would be unusual for a claimant to end up in a better position, so it seems strange that the compensation, whatever its level, should be taxable.

Take the example where an individual transfers cash, of say £2million to their solicitor for the purchase of a property, and that money is misappropriated. If the individual were unable to obtain repayment, but sued the solicitor and was eventually compensated it would appear that £1million of the compensation would be taxable under the proposed new rules. The compensation simply restores the cash and there is no profit to the individual. The cash was not a chargeable
asset so it would seem anomalous to tax it, which was presumably the purpose of ESC D33.

The Government is concerned that compensation which represents a profit or gain that an individual would have made but for the wrong, and which would have been taxable (or ought “reasonably” to be taxable) should still be taxable.

In practice it is likely that any compensation awarded or agreed would be grossed up (the Gourley principle) to cover the tax cost, so ultimately it will be the party at fault or their insurers who may have to bear this additional cost.

In their summary of responses the Government stated that before deciding on the next course of action the concerns raised would be discussed in more detail with the respondents and this is progressing at present.

It is proposed that two further parts of the ESC are legislated and extended as follows.

Receipt of damages for wrong or injury suffered by an individual personally or in their profession or vocation are exempt under statute – section 51 TCGA 1992. The Government is proposing to extend this where the wrong or injury is to an individual in their trade or employment, and also where compensation is paid to relatives or personal representatives of a deceased person for distress or loss of financial support.

Finally, there is a proposal to extend section 49(1)(c) TCGA 1992, which deals with adjustments to capital gains computations where warranty payments are made, to include payments under indemnities. Whilst there is a legal difference between warranties and indemnities, their commercial impact (usually a repayment of proceeds) tends to be identical.

Both of these proposals received universal support and the Government will consider legislating them along with whatever is decided upon in relation to limiting the exempt amount once the consultation has been finalised.

It may be difficult to draft legislation that will deal with exempting compensation where there has been no gain or profit, whilst limiting the amount (or indeed perhaps taxing without limit) compensation that does represent profit. However, it is apparent that HMRC is keen to understand the issues clearly and it is to be hoped that the eventual legislation will be easily understood and result in a logical outcome.

Profile

Gillian is a director in PwC’s private client practice in the North West. She is a chartered accountant who has worked for the firm for over 25 years. Gillian advises on all aspects of personal tax, and has a particular interest in families and family businesses. Gillian can be contacted on +44 (0)161 245 2922 or at gillian.m.banks@uk.pwc.com
BUSINESS INVESTMENT RELIEF: UNPREDICTABLE AND CONVOLUTED

John Barnett highlights the facts. It is a shake-up that is long overdue

Business Investment Relief (BIR) is a generous tax relief that is available to non-UK domiciled and UK resident non-domiciled taxpayers who are or have been remittance basis users.

The operation of BIR is such that non-domiciled individuals remit their offshore income and gains into the UK without being taxed on that remittance. A BIR claim is made via the self-assessment tax return.

One of the main advantages of BIR is that relief is unlimited in both value and duration, i.e. there are no maximum thresholds or annual limits. Therefore, as long as the investments meet the BIR conditions, BIR will apply to 100% of the funds to be remitted.

The main condition to be satisfied for BIR to be applicable is the occurrence of a 'relevant event' which means that the remitted funds are being invested (via shares or loans) in the right type of company (namely, an unlisted trading company).

There are additional conditions to be satisfied. These can be problematic and the result has been that the uptake of BIR has not been as high as was initially expected.

The CIOT raised a number of such issues in an open letter to HMRC in September 2013. These problems were identified as deterring potential investors from claiming BIR.

First, the 'extraction of value' rule is unnecessarily complicated and arbitrarily binary in its operation. This rule is that where any value is extracted either from the BIR company or any company that is, broadly speaking, associated with that company, BIR is lost on the entirety of the funds invested. The CIOT has suggested a proportionate clawback of BIR based on the proportion or amount of value extracted. This suggestion has not yet been followed-up by HMRC and may be challenging to achieve within the scope of the current legislation. The issue may be considered in the upcoming consultation (see below).

Second, the CIOT has raised the question with HMRC as to whether there should be an automatic exemption from the extraction of value rule for de minimis or trivial benefits.

Third, the Condition B rule provides a broad brush statement that BIR cannot be used in any scheme or arrangement for which the main purpose is the avoidance of tax. The CIOT has commented that this provides an unnecessarily unpredictable element to BIR.

Fourth, there has been a common scenario which BIR does not, as it stands, cater for: Where the investment is made from the investor’s offshore bank account into a bank account held by the target company which is also held offshore. This means that the funds to be invested are not the same event as the remittance into the UK and therefore cannot qualify for BIR. The general advice from both practitioners and HMRC has been to remit the funds into the UK through a transfer to the investor’s UK bank account prior to making the investment and therefore bring the funds unequivocally within the
remit of BIR. We believe that this issue is unlikely to be addressed by way of legislative reform in the upcoming consultation but HMRC may issue further guidance to help deal with this common occurrence.

HMRC has, broadly, understood these issues for some time. However, the political will to do something about them has until now been lacking. Fortunately, that has changed with the announcement in the Autumn Statement 2015 of a consultation on BIR — we expect more on this shortly.

Initial conversations with HMRC indicate that the scope of the consultation is likely to include a number of the above issues including:

(a) Considering amending the ‘extraction of value’ rule to make it more investor-friendly

(b) Considering providing an exemption for trivial or de minimis benefits derived as extraction from a target company

(c) Looking at whether BIR investment is targeting the correct type of company and therefore encouraging the right kind of investment. For example, there is a general Governmental policy position that is opening up the residential housing market with a focus away from encouraging buy-to-let properties and therefore property rental companies may be excluded, or restricted from claiming BIR going forward

(d) Considering whether the rules are adequate to prevent ‘recycling’ of funds. This is where BIR is being used to invest in a target company which then buys land from an individual with the proceeds of the sale then being transferred to the individual seller. Although this is within the permitted ambit of BIR as the legislation is currently drafted, HMRC may introduce revised or additional sections to the legalisation to prevent, or restrict, this practice.

The scope of the consultation is as yet unconfirmed but it is likely to last for twelve weeks and introduce new legislation for April 2017.

The main aim of the consultation will be to simplify the rules for claiming BIR so that additional funds will be remitted into the UK from offshore investors to promote UK businesses and therefore, ultimately, benefit the UK economy.

Profile

John Barnett is a Partner at Burges Salmon in the Private Client and Wealth Structuring department. He specialises in both international and corporate tax. In 2013 he was appointed by HMRC to the interim panel set up to approve guidance on the new General Anti-Abuse Rule (GAAR). John is a member of the CIOT’s Council. John can be contacted at john.barnett@burges-salmon.com or on +44 (0) 117 902 2753.
ENTREPRENEURS’ RELIEF: CHOPPY WATERS

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 is 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.

Profile

Kevin Slevin is a chartered tax adviser, providing consultancy services to other practitioners. His books include Slevin’s Guide to the Enterprise Investment Scheme and Slevin’s Guide to Entrepreneurs’ Relief.

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