FA 2015 – changes to entrepreneurs' relief

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Changes to entrepreneurs' relief (ER) were announced at Budget 2015 to take effect from the same day, 18 March 2015. These changes are contained in FA 2015, and concern restricting ER on associated disposals (FA 2015 s 41) and on joint ventures (JVs) and partnerships (FA 2015 s 43). We understand that the CGT manual will be updated for these changes over the summer.

In comments made to HMRC, the CIOT has expressed concern that these changes to the legislation were introduced with immediate effect without consultation. In addition, because of the tight timescales of the passage of Finance Bill 2015 through parliament, there was no time for parliamentary scrutiny of the legislation before it was enacted to address concerns that it could lead to unfairness or unintended consequences.

Section 41 – associated disposals

This amends TCGA 1992 s 169K so that ER will no longer be available for an associated disposal where the relevant material disposal is less than a 5% interest in the relevant business.

The policy objective is to prevent ER being claimed on the disposal of a personal asset, held outside the business, when there is not also a meaningful disposal of business assets or company shares. The measure will deny ER on an associated disposal unless there is also a disposal of an interest of 5% or more in partnership business assets or company shares.

Our concern is that this change will prevent ER being claimed where there is a material interest in the business, but that share is relatively small.

Take a farming partnership where there are interests held over two or three generations: the result could be that several persons may have an interest in the partnership but, for some, their individual shares could be quite small. If land used by the partnership was held outside the partnership and the land and either the whole or part of the business was sold, it would seem that a person with a small interest in the partnership would not receive ER on any share of the land held outside the partnership. But, had the land been owned by the partnership, the individual would qualify for ER on their interest in it under s 169I (being a material disposal of business assets).

In addition, where the share of the business assets/company shares disposed of consists of the whole or a significant share of the individual's interest in the business we think that ER should be available on an associated disposal of an asset held outside the business.

We do not think that it can be right to prevent ER being given on an associated disposal just because a person has only a small share of the business. This would be the case when the individual has been passing on the business to later generations, but has until now retained assets used by the business in their own name.

We suggested to HMRC that the new conditions to s 169K are qualified so that they are met if P's disposed-of interest is less than 5% but is either the whole or a substantial proportion of P's interest in the business.

Section 43 – joint ventures and partnerships

This amends TCGA 1992 s 169S so that, for ER purposes, the definitions of a 'trading company' and 'the holding company of a trading group' do not take account of activities carried on by JV companies in which a company is invested, or of partnerships of which a company is a member.

The policy objective is to ensure that those who benefit from ER have a 5% directly-held shareholding in a genuine trading company. This measure will deny ER on a disposal of shares in a company that is not a trading company in its own right.

The policy intention is that individuals must have a significant stake in a genuine trading business in order to benefit from ER. But we can foresee that the proposals could affect more than just structures that have been set up under which people

with only a small indirect stake in the trading company can benefit from ER. We also point out that activities in JVs have hitherto been expressly permitted by legislation.

It is not uncommon for unconnected parties to work together on a project by forming their own holding companies which then form a JV company to develop the project. Three individuals, for example, might each set up a company which in turn owns one-third of a JV company. It appears that these three individuals would no longer qualify for ER on a disposal of their shareholdings, since their companies do not themselves carry on a trade.

The wording of new TCGA 1992 s 169S (4A) describes the partnership activities of a corporate partner as being treated as ‘not trading activities’. This could be interpreted as meaning that it would affect the corporate partner’s entitlement to ER on a trading activity (carried on it its own right) in the same way that rental income does. We query whether this is the intention and suggest that it would be better to have worded ss 4A to say that such partnership activity is disregarded rather than being not trading. Similarly, it seems that it is only the trading activities of the JV company that are to be ignored, not the JV company itself when determining the trading status of the company in which shares are held directly. If this is the case, we can envisage a situation where the value of the JV investment overwhelms the value of any trade and trading assets the direct company might have itself and would mean that its own trade could be insufficient to qualify for ER. This seems particularly harsh.

Finally, we suggested to HMRC three other ways to deal with the perceived problem:

1. Instead of requiring an individual to hold at least a 5% stake directly in a company carrying on a trade, the restriction might be amended to require either a direct OR indirect holding. This would go some way to ensuring that individuals involved in genuine commercial arrangements could still have access to ER on a disposal of their shares, but people with only very small indirect stakes cannot benefit from ER. However, we can see that this suggestion might not fit with the overall policy intention.
2. A transitional exemption for those structures already in place by, for example, permitting share disposals for five years (long enough for genuine trades to have developed and become ready for market) to operate under current legislation.

3. The new regulations could apply only where more than five shareholders in the company investing in the JV company each holds less than 5% of the share capital.

The CIOT's comments on ss 41 and 43 can be read here.