Investment relief: unpredictable and convoluted

Personal tax | Tax voice



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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:

1. Considering amending the ‘extraction of value' rule to make it more investor-friendly
2. Considering providing an exemption for trivial or de minimis benefits derived as extraction from a target company
3. 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
4. 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.