EXPLANATORY NOTE

ENTREPRENEURS' RELIEF: EXCLUSION OF GOODWILL IN CERTAIN CIRCUMSTANCES

SUMMARY

1. Clause [X] amends the provisions for computing entrepreneurs' relief (ER) due on certain disposals of businesses by an individual or a member of a partnership to a company. Where the new provisions apply, the ER rate of capital gains tax (CGT) will not apply to gains on the business' goodwill, but gain on other business assets are not affected. The new provisions apply to disposals on or after 3 December 2014. They remove a tax incentive to incorporate an existing business.

DETAILS OF THE CLAUSE

2. Clause [X] amends Chapter 3 of Part 5 of the Taxation of Chargeable Gains Act 1992 (TCGA 1992). Paragraphs 1 – 3 are introductory and make minor amendments.

3. Paragraph 4 of Clause [X] inserts new section 169LA into TCGA 1992.

4. Subsection (1) of new section 169LA sets out the two conditions for subsection (3) to apply. These are that a person (P) disposes of goodwill as part of a qualifying business disposal directly or indirectly to a close company (C), and that P is a related party in relation to C at the time of the disposal.

5. Subsection (2) of new section 169LA explains what is meant by 'a related party'. The definitions in Part 8 of the Corporation Tax Act 2009 (CTA 2009), specifically at section 835 of that Act, apply for the purposes of this measure. This provides that, for the purposes of this Clause, P will be a related party in relation to company C if for instance P is a participator (or an associate of a participator) in C, or if P is a participator (or an associate of a participator) in a company that controls or holds a majority interest in C.

6. Subsection (3) of new section 169LA provides that, where the conditions in subsection (1) are met, the goodwill is not a relevant business asset for the purposes of section 169L TCGA. This means that a gain or loss accruing on the disposal of the goodwill will not enter into the computation of the amount under section 169N subsection (1).

7. Subsection 4 of new section 169LA provides that the reference to a close company in subsection (1) includes non-UK companies which would be close if they were in fact UK resident. A close company is essentially one which is controlled by five or fewer participators, or by participators who are also directors. This extended meaning of 'close company' also

applied for the purposes of deciding whether parties are related (see subsection 2 of new section 169LA).

8. Subsection (5) of new section 169LA is an anti-avoidance provision. It ensures that subsection (3) will apply where a person disposes of goodwill and is at the time of the disposal party to 'relevant avoidance arrangements' if, in the absence of this provision, it would not otherwise apply.

9. Subsection (6) of new section 169LA explains what is meant by 'relevant anti-avoidance arrangements'. They are arrangements which have a main purpose of ensuring either

- that gains on goodwill will contribute to the gain which is subject to the special ER rate of tax or
- that the person making the disposal is not (for any purpose) a related party in relation to a company to which the disposal of goodwill is directly or indirectly made.

10. Subsection (7) of new section 169LA ensures that 'arrangements' has a very broad meaning for the purposes of subsection (5).

11. Paragraph 5 of Clause [X] provides that the new section 169LA has effect in relation to disposals of goodwill made on or after 3 December 2014.

BACKGROUND NOTE

12. These new provisions are effective from the date of their announcement at Autumn Statement in order to prevent the forestalling which would otherwise be likely. Draft legislation and a Tax Impact Information Note have also been published: together with these explanatory notes and the Autumn Statement itself, they provide a comprehensive picture of the changes proposed.

13. This measure supports the government’s objective to have a fair tax system for all.

14. This measure is complementary to another measure announced at Autumn Statement 2014 which denies relief in computing corporation tax profits in respect of the cost of goodwill purchased in comparable circumstances. Together, these measures remove two incentives which encourage incorporations of businesses for tax reasons rather than for the genuine commercial benefits which may follow from a business being carried on by a company rather than by an individual. HMRC has observed an increasing trend amongst professionals and specialist traders to incorporate their businesses in order to gain these tax advantages.

15. These two measures allow businesses carried on by individuals and partnerships (unincorporated businesses) to compete more fairly with similar businesses carried on by companies.

16. If you have any questions about this change, or comments on the legislation, please contact Rob Clay on 03000 570649 (email: rob.clay@hmrc.gsi.gov.uk).