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HMRC CAPITAL TAXES LIAISON GROUP MINUTES

Minutes of meeting of 1 May 2015 of HMRC Capital Taxes Liaison Group published by ICAEW Tax Faculty in July 2015

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CONTENTS

FOREWORD

The HMRC Capital Taxes Liaison Group is an HMRC led group providing an interface between professional bodies and officials at HMRC to discuss capital tax matters and resolve issues where possible.

The last meeting was held 1 May 2015 and HMRC have agreed to the publication of the minutes and associated briefing paper on Entrepreneurs' Relief and Finance Act 2015.

HMRC Capital Taxes Liaison Group Meeting

HMRC, 100 Parliament Street, Westminster, London, SW1A 2BQ
Room G/57
12:00 – 1 May 2015

Chair - Mike Crabtree – HMRC
Secretary - Owen Price HMRC

1) Introductions/apologies etc

1. The chair welcomed the attendees and opened the meeting. Introductions were made and apologies noted.

2. The Chair reminded attendees that the Civil Service was in a period of "purdah" due to the forthcoming General Election. The Chair explained that because of this there were strict limits to what could be discussed and what HMRC could comment on.

2) Matters Arising from Previous Meeting

3. The notes of the previous meeting have been agreed. There were no matters arising raised by the Group or by HMRC.

3) CGT and Non-Residents

4. HMRC provided a brief background on the measure.

5. The relevant legislation is now in place. HMRC explained that they had worked with stakeholders on much of the legislation through a series of working groups and hope that the changes from the draft exposed last December address most of the concerns that were raised.

6. HMRC acknowledged that the legislation also contains provisions that were not exposed in draft last December (e.g. payments on account; pooling; and interactions with hold-over and roll-over reliefs) and stakeholders are urged to provide feedback on any issues that arise.

7. The form to notify HMRC of the disposal of a property is now on gov.uk at https://www.gov.uk/capital-gains-tax-for-non-residents-uk-residential-property#reporting-and-paying-capital-gains-tax. The form will be reviewed and updated in due course. Some stakeholders reported their members had had some difficulty locating the form on gov.uk.

8. HMRC have produced for internal use a document showing the consolidated changes to private residence relief. HMRC agreed to share this with Group members.

   Action Point - HMRC to circulate consolidated PRR legislation.

9. There was limited feedback from the Group. However, a Group member expressed surprise that PRR final period relief was available in full if a non-resident's use of a dwelling as their main residence occurred prior to April 2015.

10. Some Group members have been approached by clients asking whether they should seek a valuation of their property now, regardless of whether they intended to sell.

11. HMRC confirmed that initially all tax returns will be dealt with by the Self Assessment team in Leicester.

4) Entrepreneurs’ Relief Update

8. HMRC provided an overview of two of the four Entrepreneurs’ Relief measures included in Finance Act 2015.

<u>Feeder Companies – S43 FA 2015</u>

8a. The policy aim of this measure is to stop ER being allowed on shares where the claimant does not have the necessary 5% stake in a company which is either a trading company in its own right or the holding company of a trading group.

9. This is achieved by amending the definition of 'trading company' (taken from s165A TCGA92) so that the activities of a joint venture company are no longer treated as carried on (pro-rata) by the investor company.

10. Instead, HMRC will look at the investing company's own activities, which include the holding of shares in any joint venture companies, and apply the established principles relevant when deciding a company's trading status in other contexts (e.g. substantial shareholding relief).

11. Group members felt that the new rules prevent ER from being claimed on shares in companies which are engaged in bona fide commercial activity. In particular, Group members explained that partnership structures are often used for genuine commercial reasons because it is easier to add or remove partners than it is to add or remove shareholders.

11a. Group members expressed the view that companies might adopt less appropriate structures to ensure entitlement to ER is not lost. It was also felt that HMRC may see an increase in requests for non-statutory business clearances.

12. It was stated that within the Private Equity industry, the 5% condition for direct shareholding in a trading company is not seen as a major issue. However, Group members said that they would like to better understand the policy intention behind the 5% rule.

13. HMRC stated that they believe that a 5% shareholding demonstrates a material interest in a company, although they recognised that as companies grow shareholdings can dilute.

14. Group members suggested that an alternative to the 5% rule would be to look at the number of hours an individual worked for a company.

15. HMRC asked whether Group members had been approached by clients that were actually considering changing their company structure as a result of the new rules. Group members replied that in the main customers are awaiting further guidance from HMRC but there is concern that HMRC has “moved the goalposts”.

16. Group members expressed disappointment with the lack of consultation over the new rules and questioned the proportionality of the changes in light of the expected Exchequer impact.

17. HMRC stated that whilst it is desirable to consult on changes, it is not always possible, particularly when changes form part of major fiscal events.

18. HMRC asked Group members to provide comments on the new changes, particularly around arbitrary or unfair outcomes in writing to the Secretary.

Action Point - Group Members to provide written comments on ER changes.

<u>Associated Disposals – S41 FA 2015</u>

19. The policy aim of this measure is to prevent ER being due on disposals of privately-owned assets which have not been genuinely used in a business, or when the disposal is not accompanied by a meaningful withdrawal from the business.

20. This is achieved by requiring the qualifying business disposal with which the private asset disposal is associated to be of at least 5% of the shares in the claimant's personal company, or at least 5% of the claimant's partnership's assets.

21. Group members were concerned that the anti-avoidance provision prevents ER being due when a family member retires from a partnership and transfers a privately-owned asset to another partner, for example a multi-generational farming partnership.

22. Group members were unsure how to apply the 5% test because determining ownership is less straightforward with partnerships than with shareholdings.

23. HMRC again asked Group members to provide comments on the new changes in writing to the Secretary.

24. HMRC stated that they are keen that Group members have the opportunity to air their views and they will endeavour to respond quickly.

5) IHT Online

17. HMRC is introducing a new digital system for Inheritance Tax.

18. HMRC explained that the new system is not just a method for filing IHT returns electronically – rather it is part of a larger project aimed at making the whole process more efficient for all parties involved.

19. Beta testing is scheduled to begin in August 2015 for a limited number of cases. HMRC expect the new system to be phased in for the public from September or October 2015, initially with “simple” non-taxpaying estates, with full IHT400 accounts from individuals and agents being accepted from March/April 2016. Over the longer term, HMRC hope to be able to provide access to the service via third party software.

20. Customers will access the service via gov.uk and it is hoped that customers will find the system simple and intuitive. HMRC expect the service to be similar to Self Assessment online, allowing customers to make payments, claim repayments and check statements.

21. HMRC stated that minor legislative changes are required to make provision for the filing of online IHT returns. HMRC also intend to use this opportunity to bring in the interest and penalty regime from Finance Act 2009 for IHT.

22. Group members asked whether it will be mandatory to file online. HMRC stated that it will not be mandatory and paper returns will remain available for those who are unable or unwilling to file online. Group members also asked if there will be a facility to enable to

individuals to provide details of the assets in the estate before they die, or to pay any IHT due early.

6) AOB

23. A Group member had recently checked his online Trusts account and had noticed that penalties were showing, despite the accounts having been filed on time. HMRC are aware of this issue but will investigate further.

24. Group members expressed disappointment that the "Frankland trap" had not been dealt with in Finance Act 2015.

25. Group members asked if HMRC had a timescale for the consultation on Deeds of Variation announced at Budget 2015. HMRC advised that this is a matter for Ministers.

26. Group members felt that SI 616 of 2015, introducing changes to the method for valuing shares, was not well publicised and asked if there was a difference in the treatment for IHT purposes.

27. A Group member cited a recent case he had been involved with, in which HMRC had issued a revised IHT calculation 8 years after the initial IHT return had been filed. The Group member expressed the view that this situation was unfair.

28. HMRC advised Group members of personnel changes in HM Treasury.

29. The next meeting will be arranged for September or October 2015.

Minutes prepared by HMRC Assets and Residence Policy.

Brief for Capital Taxes Liaison Group 01 May 2015

Entrepreneurs' relief measures in FA 2015

Key words	**Statute**
Feeder companies "ManCos" Joint ventures Activities in a partnership	S43 FA 2015 S169S TCGA S165A TCGA
Associated Disposals	S41 FA 2015 S169K TCGA
Goodwill Incorporation	S42 FA 2015 New S169LA TCGA
ER on deferred gains	S44 FA 2015 New Ss169T, U, V TCGA

Feeder companies

Policy aim: stop ER being allowed on shares where the claimant does not have the necessary 5% stake in a company which is either a trading company in its own right or the holding company of a trading group.

Mechanism: amend the definition of 'trading company' (taken from s165A) so that the activities of a joint venture company are no longer treated as carried on (pro-rata) by the investor company. Instead, we look at the investing company's own activities, which include the holding of shares in any JV companies, and apply the established principles relevant when deciding a company's trading status in other contexts (e.g. substantial shareholding relief).

ALSO, activities carried on by a company in its capacity of partner in a firm are treated as non-trading activities for ER purposes (regardless of their actual nature).

Objections (various stakeholders): we have denied ER on shares in many companies which are engaged in bona fide commercial activity through the media of joint ventures and partnerships, where (a) there is no tax planning purpose in adopting the structure, and (b) the shareholder does have an effective 5% stake in the underlying trade carried on by the JVCo (as required for 'proper' ER). We have removed certainty that ER will be due, by shifting scrutiny to the investing company's own activities.

Comments:

ER is not seen as a reward for mere passive investment [though the 5% condition for direct shareholding in a trading company might be seen as suggesting that it is].

It is not right that an individual with a relatively small, indirect stake in a trading company should be guaranteed relief on that stake.

The new rules may increase uncertainty in some cases, but this is because the old rules afforded too much certainty by being too generous: virtually guaranteeing relief in cases where it should not have been assured.

Partnership activities had to be treated as non-trading to prevent the new JVCo rules being sidestepped. All partners are treated as carrying on the firm's business in common but in practice many 'sleeping partners' do little or nothing, so if we allowed a partner company's activities to include those of the partnership we would be back with the risk of a passive investment qualifying for ER. Moreover, because there is now no limit on the number or partners in a firm, a very large number of shareholders in partner companies could qualify for ER on their shares because each passive partner company could be its shareholders' personal trading company.

Associated disposals

Policy aim: prevent ER being due on disposals of privately-owned assets which have not been genuinely used in a business, or when the disposal is not accompanied by a meaningful withdrawal from the business

Mechanism: require the qualifying business disposal with which the private asset disposal is associated to be of at least 5% of the shares in the claimant's personal company, or at least 5% of the claimant's partnership's assets. ALSO prevent relief where these conditions are met, but there are arrangements by which the claimant (or persons connected with him/her) can recover the shares/assets disposed of: an anti-avoidance provision.

Objections (various stakeholders): the anti-avoidance provision prevents ER being due when a family member retires from a partnership and transfers a privately-owned asset to another partner e.g. a multi-generation farming partnership where grandpa holds the land personally and wants to pass it to one of his children. Apparently it is common for such partnerships to provide for continuing partners (i.e. family members: connected persons) to acquire the retiring partner's partnership asset shares, thus falling foul of our anti-avoidance rule.

Comments: The 'problematic' scenario is one of those in which we don't think relief should be due. The would-be claimant is alienating the asset, but plainly the benefit of private ownership remains in the family and so it is reasonable to infer that the claimant will not necessarily have relinquished all beneficial ownership. The answer is for the would-be claimant to transfer his private asset to the partnership.

Goodwill on incorporation

Policy aim: prevent use of ER to move sums extracted by a sole trader or partner from his or her business from income to capital account, thus swapping income tax/NICs over several future years for a 10% CGT charge up-front on incorporation.

Mechanism: move gains on goodwill from the scope of ER, where the transfer is to a close company to which the claimant is a 'related party'. (NB: 'relatedness' is a CTA concept which is broader than connectedness or association. Broadly, if P or anyone associated with P is or may become a participator in a company C then P is a related party in relation to C.)
Objections: the scope of the measure is far too wide: it denies ER to people who have – or will have – only a minority shareholding in the successor company, and who will not be able to continue to direct and control their former business after it is transferred to the company. The measure will therefore discourage legitimate commercial activity such as

- sell-outs in which the purchaser would expect to retain the services of the vendor/proprietor and incentivise her with a small shareholding
- raising capital from external investors who tend to want to invest in companies, so an existing partnership may have to incorporate the business in order to grow it
- adopting alternative business structures in the legal profession (recently permitted by new law)

Comments: I have some sympathy with these points, but the overriding concern would be that the flexibility of share capital and the possible use of geared growth shares make it impossible safely to define an 'acceptable' minority shareholding below which ER might still be allowed.
Incorporation relief (section 162 TCGA) is often available when the vendor is taking no cash or debt from the successor company: the gain latent in the business assets is rolled-over into the consideration shares received.
Several correspondents have proposed that HMRC should offer an advance clearance service, similar to that provided for share-for-share exchanges and company reconstructions, but the move in UK tax administration has been very strongly away from such arrangements in recent years.

<u>ER on deferred gains</u>

Policy aim: permit ER to be claimed on gains which are treated as accruing after having been reinvested in EIS shares or social investments, providing ER could have been claimed when those gains first accrued i.e. before deferral.
Mechanism: technical changes to the definitions of gains on which ER may be claimed and the procedure for making certain claims.
Objections: none, except that the statutory language is opaque.
Comments: I agree about the language.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)

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