Disassociated disposals?

KEVIN SLEVIN digs a little deeper into the facts of a recent Readers' Forum question on associated disposals and concludes that capital gains tax entrepreneurs' relief should be available.

I was surprised that two presumably unconnected respondents to a Readers' Forum question on associated disposals had each concluded that the circumstances described by the questioner could be construed as involving a 'share purchase arrangement' (see 'Winding down', *Taxation*, 12 January 2017, page 23 – tinyurl.com/jglbxjy). The existence of such arrangements will result in the loss of entrepreneurs' relief in respect of a gain arising on what would otherwise be an associated disposal. I was shocked when I looked again at the legislation in TCGA 1992 only to realise that they had made, on the face of it, a very good point.

To briefly recap, the question concerned a sole practitioner accountant operating through a limited company owned 65% by him and 35% by his wife. The accountant owned the trading premises which the company uses rent-free and he wished to sell these to a self-invested personal pension (SIPP). At the same time, he would dispose of between 5% and 10% of his shares to his adult son who is also a qualified accountant and will eventually take over the business. The question was whether the disposal of the trading premises would qualify for entrepreneurs' relief.

KEY POINTS

- A father intends to pass shares to his son at the time of an associated disposal.
- Could the possibility of a subsequent share transfer to the son be deemed a 'share purchase arrangement'?
- FA 2015 introduced the 5% disposal test.
- The measure to counter avoidance using 'share purchase arrangements' was introduced by FA 2016.
- HMRC agrees that the 'share purchase arrangements' are not intended to include genuine commercial succession arrangements.
- Remember that the 5% disposal test relates to the total shares in the company rather than the individual's shareholding.

The law

The associated disposal provisions in TCGA 1992, s 169K were amended first, with effect from 18 March 2015, by FA 2015, s 41 and further amended, again with effect from that same date, by FA 2016, s 84.

The FA 2015 changes were intended to counter certain tax avoidance arrangements relating to associated disposals. For a disposal of an asset owned outside the business entity to be considered an associated disposal falling within s 169K it is necessary to demonstrate that the asset in question is disposed of as part of the taxpayer's withdrawal from participation in the business. This applies whether the business is carried on by a partnership or a trading company.

Before FA 2015, the 'withdrawal from the business test' could be satisfied if the taxpayer could show that he had disposed of all or some of his interest held therein – be it a reduction in his stake in the partnership or, in situations where the business activity is carried on within a corporate structure, a reduction in the number of shares held.

FA 2015 introduced a simple measure, which required that the withdrawal from the business had to comprise, as a minimum, a 5% interest in the partnership or a holding of at least 5% of the relevant company's ordinary share capital that carry at least 5% of the voting rights. This measure was an understandable change to the law given that some individuals were hitherto contriving to bring a disposal within the associated disposal provisions. They did this by engineering a tiny disposal out of their interest in the business using the asset in question and this remains unaltered by the FA 2016 changes.

As well as the previously growing practice of contriving associated disposals as above, it seems that some were of the view that the associated disposal status would not be lost in situations

TONY

Tony owns 123 High Street, a commercial property used rent- free by Tony Ltd – a trading company that is owned 80% by Tony and 20% by his son, Jim.

In 2014, Tony received an unsolicited offer for the trading premises, which would form part of a redevelopment scheme proposed by a major developer. Following the grant of planning permission, he is set to make a £5m capital gain. Tony has no desire to retire from Tony Ltd and the company is to carry on trading after moving to new rented accommodation.

Tony seeks advice from Pushit, Grabbit & Co and is told that a capital gain arising on a simple sale of an asset used by Tony Ltd will not attract entrepreneurs' relief. However, he was advised to engineer a disposal of a holding comprising, say, 10% of the ordinary shares in Tony Ltd to his son. This would create the material disposal of business assets required under TCGA 1992, s 169K.

Tony was reluctant to reduce his shareholding by any amount. 'No problem', was the advice received from the tax partner in Pushit Grabbit & Co. 'Simply gift the shares to your son and tell him that, if he knows what is good for himself in the long run, he will decide to transfer the shares back to you in a few months' time, ideally on a date in the next tax year. Simple.'

where it was clear to all that the reduction in participation in the business was merely a temporary measure.

The example of ***Tony*** demonstrates the abuse that was (but is no longer) taking place.

The counter measure

Arrangements such as that outlined in the example of ***Tony*** were brought to an end by FA 2016, s 84, which introduced an additional test that applies from 18 March 2015 (see TCGA 1992, s 169K(1B)(b)). Thereafter, in the case of a disposal of shares intended to be a material disposal for the purposes of s 169K, there must not exist any 'share purchase arrangements' as at the date of the transaction.

A similar provision (in s 169K(1AA)(c)) relating to disposals of interests in partnerships requires that no partnership purchase arrangements must exist at the time of such a disposal. However, for the sake of simplicity, we will focus here on share disposals; in other words, the type of disposal referred to in the 'Winding down' query.

The measure to counter avoidance in situations involving 'share purchase arrangements', as finally reflected by FA 2016, was intended to prevent individuals exploiting the associated disposal provisions by nullifying the potential to claim relief when a taxpayer's material disposal of shares (in the company using the asset for its trade) is intended to be no more than a temporary arrangement.

Individuals claiming relief must not have entered into a share purchase arrangement, which is defined by s 169K(1E) as meaning any arrangement (other than the material disposal itself) under which the taxpayer or a person connected with him is entitled to acquire any shares in or securities of the company whose shares are comprised in the material disposal (or of a company which is a member of the same trading group as the company in question).

Section 169K(7) defines 'arrangements' as including any agreement, understanding, scheme, transaction or series of transactions, whether or not legally enforceable. And subsection 8 states that a person is treated as entitled to acquire anything that the person is entitled to acquire at a future date, or will at a future date be entitled to so acquire. As highlighted in the responses to the reader's query, a sensibly wide definition.

Creation of an arrangement?

In the reader's query, there is no suggestion of any form of reciprocal arrangement as regards the shares. What is implied by the questioner is that, at the same time as the business premises are disposed of, the director will dispose of not less than 5% of the company's ordinary share capital to his adult son.

The questioner goes on to explain that the adult son will eventually take over the business. By implication, this eventual takeover will involve the acquisition of shares in the company. Accordingly, the replies to the query express concerns that HMRC might argue that, at the time of the initial disposal of shares to the adult son, there exists an agreement or understanding (whether or not legally enforceable) under which a person connected with the taxpayer (his son) will acquire shares in the company.

The question is, therefore, whether such a scenario creates a share purchase arrangement within s 169K(1E) under which the taxpayer *or a person connected with him* is entitled to acquire shares in the trading company.

Intention of the legislation

It is clear from HMRC's public announcements that the introduction of the provision relating to the existence of share purchase arrangements was intended to prevent a claimant regaining his stake in the business (directly or indirectly) after purporting to meet the requirements of condition B; in other words, regaining shares in a company after asserting that he has made the asset disposal as part of his withdrawal from participation in the business carried on by the company in question so as to enjoy entrepreneurs' relief.

On reflection, the wording of the legislation could have been clearer to eliminate any possibility of a phased acquisition of a stake in a family business by a connected person in genuine commercial circumstances from being in danger of being considered as a share purchase arrangement. However, in practice, HMRC can be expected to interpret the legislation as applying only when the taxpayer is trying to reacquire all or part of his former holding.

HMRC has advised me that the definitions of share purchase arrangements are such that they are not intended to catch genuine commercial succession arrangements of the sort described in the reader's query and will not be construed as doing so.

Further, the *Finance (No 2) Bill 2016 Explanatory Notes* on cl 73 (which became FA 2016, s 84) state at paragraph 12 that new s 169K(6A) 'ensures that pre-existing arrangements (unconnected to the material of associated disposal) for succession to a business, or ownership of shares in the event of retirement or death, will not prevent a claim to entrepreneurs' relief on an associated disposal'. This would seem to dispels the concern relating to the understanding that the client's son will eventually take over the business.

It is also worth highlighting the explanatory note on new s 169K(3BA) which amends the definition of 'share purchase arrangements'. Where the associated disposal takes place before the material disposal this ensures that 'any arrangements connected with the latter cannot be share purchase arrangements and thereby prevent entrepreneurs' relief on an associated disposal'. This should dispel the fear that the share transfer from father to son falls within this.

Subject to the small, but important qualification below, I would expect the taxpayer described in the Readers' Forum query to qualify for entrepreneurs' relief under the s 169K associated disposal rules without having to worry about the share purchase arrangements provision. This is subject to the proviso that there is no suggestion at the time of the share disposal that this will be in any way restored to disposer. In my view, for an HMRC caseworker to seek to prevent entrepreneurs' relief in such circumstances would be contrary to the department's own policy. Should any reader experience a caseworker taking a different approach they should asked for the case to be referred to HMRC's specialist capital gains tax team in Solihull (tinyurl.com/zbjchkm). HMRC's internal capital gains tax consultants are expected to be briefed accordingly and consequently this point should not arise in practice.

The caveat referred to above arises out of the wording of the reader's question and is as follows. The questioner states that his client 'owns 65% [of the shares] and 35% are owned by his wife' adding: 'At the same time [as the property disposal] he intends to make a disposal of between 5% and 10% of his shares … to his adult son.'

It is important to note that, to meet the 5% test in Condition A2 in s 169K(1B), a shareholder possessing 65% of the only class of ordinary shares in issue would have to make a minimum disposal of 7.7% of their holding. In the case in point, a disposal of 5% of the client's shares would amount only to the disposal of a 3.25% stake in the company.

Conclusion

After considering the Readers' Forum question, the replies and the legislation in detail, I can only conclude that the respondents have made a fair point. However, practitioners and their clients should not find that entrepreneurs' relief is refused in instances such as described in the query.

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