UK200Group tax
talking tax

Issue 89 – November 2012

Entrepreneurs' Relief associated disposals – when they should take place…

I was asked the question recently, when should an associated disposal take place and whether it would be sufficient to be at the same time as a material disposal or whether it should be made after?

The wording governing associated disposals can be found at s169K of TCGA 1992 and this provides that three conditions (conditions A, B and C with condition C relating to the necessary qualifying period) must be met for there to be an associated disposal.

A 'material disposal of business assets' is condition A and this is laid out in s169I TCGA 1992, although I do not propose to look at this any further in this article. HMRC provide their guidance on material disposals of business assets at CG63975.

Condition B states that the disposal must be connected with a withdrawal from the business. Section 169K(5) makes it clear that the disposal referred to in condition B is the associated disposal, not the relevant material disposal.

Guidance from HMRC on the withdrawal from business is in their manuals at CG63995 and it states that Condition B is satisfied when those disposals together constitute part of the process of "withdrawal from participation in the business". The guidance goes on to state:

"Relief will not be due unless the disposal of an asset (held outside the partnership or company) is related to the individual's reduction of his or her interest in the assets of the partnership, or holding in the company, as the case may be. It is not necessary for the individual to actually reduce the amount of work which they may do for the business."

"...As the "material disposal" and the "associated disposal" must be part and parcel of one single withdrawal from participation in the business, there should normally be no significant interval between the two disposals.

However, where a partnership or company ceases to trade it is quite possible that there may be an interval between the "material disposal" and the disposal of the asset that is the subject of the "associated disposal". In such cases you may accept that a disposal of an asset is associated with a "material disposal" if the asset is disposed of –

- within one year of the cessation of a business, or
- within three years of the cessation of a business and the asset has not been leased or used for any other purpose at any time after the business ceased.
- where the business has not ceased, within three years of the material disposal provided the asset has not been used for any purpose other than that of the business."

Condition C is that, throughout the period of 1 year ending with the earlier of-

(a) the date of the material disposal of business assets, and

(b) the cessation of the business of the partnership or company, the assets which (or interests in which) are disposed of are in use for the purposes of the business.

We have two critical points in time to which the associated disposal can be linked. The first is a material disposal of business assets. The second point is one of fact, has the business ceased?

HMRC's guidance on the date of the cessation of a business is at CG64105 and states that:

"The date of the cessation of a business, or the date upon which a company ceases to be a trading company or holding company of a trading group, is a question of fact. Determining the date will usually be straightforward where trade has ceased entirely. But for less clear cut cases when there is a wide difference between possible dates and this is material to a claim for Entrepreneurs' Relief there is guidance in the Business Income Manual to assist you. See BIM70565+.

It may be more difficult to establish an exact date when a company ceased to qualify based on its having substantial non-trading activities if the change in activities is incremental and in those circumstances the date of change may be taken as the end of the relevant company accounting period."

Continued on page 2 …

The HMRC guidance at BIM70565 - Business changes: cessation: general principles, states the following:

"The date on which a business is 'permanently discontinued' (ICTA88/S63) is normally the date on which it 'closes its doors' in circumstances which turn out to be permanent. This is so even if at that time the proprietors intended or hoped to continue trading, but that expectation was not fulfilled (Marriott v Lane [1996] 69TC157, which although a capital gains tax case should be applied for income tax purposes).

However, if activity is recommenced, and the question is whether the new business is a continuation of the old, evidence of the proprietor's intention will be relevant (BIM70580).

A mere decision to wind down or dispose of the business does not of itself amount to a permanent discontinuance if trading activity in fact continues after the decision (J & R O'Kane & Co v CIR [1922] 12TC303)."

As a company is a separate legal entity an incorporation of an unincorporated trade would be treated as a cessation of the sole trader or partnership business as the individuals will no longer be in business in their own right.

Conclusion

Provided the sale of the associated asset is undertaken at the same time or within 3 years of the date a material disposal of business assets, (and where the asset has not been leased or used for any other purpose at any time after the business ceased and was also used in the business in the period 1 year before cessation or incorporation or sale), then the sale should be classed as associated and Entrepreneurs' Relief should be available.

About the author - This article was written by Tax Panel member Duncan Montgomery of Whittingham Riddell LLP, 01743 273273 - dmontgomery@whittinghamriddell.co.uk

---

Page 2 – Q&A's from Catherine Scott …

'When is a penalty allowable for tax purposes'

Page 4 – Tax Panel members and their specialisms

Members of our Tax Panel each month look at issues they have come across and share these with members and readers of UK200Group's Talking Tax.

This month's Q & As are supplied by Catherine Scott of Baines Jewitt LLP

When is a penalty allowable for tax purposes ? – McLaren Racing Ltd v HMRC [UKFTT601(TC)] …

Q What is the McLaren case all about ?

A In 2007, the McLaren racing team were required to pay £32 million to the FIA, in respect of allegations that their agents and employees had obtained, and in some way used, proprietary information belonging to another motor company (Ferrari).

McLaren claimed a deduction against profits for this amount.
HMRC considered the amount was a fine or penalty on which tax relief was not due.

Q The legislation

A HMRC argued the expenditure was not allowable under (what was) S74 (1)(a) or S74 (1)(e) TMA 1970.Those provisions prohibited a deduction where an expense was not wholly and exclusively incurred for the purpose of the trade, or for a loss which is not connected with the trade. These provisions are now found in S34(1)(a) and (b) ITTOIA 2005.

Q The arguments

A HMRC argued that McLaren should not be entitled to the deduction under the legislation as the conduct that had given rise to the penalty was outside the course of their trade. The actions taken by McLarens employees were outside the terms of their contracts of employment and the penalty was not incurred in their capacity of trader, but as a punishment for a serious breach of the rules. The penalty was to protect the reputation of motor sport, and it would be unjust for other taxpayers to share the burden of the penalty by allowing a deduction.

McLaren argued that the penalty was incurred due to the actions of its employees (even if this was unauthorised), and as such the fines were incurred wholly and exclusively for the purposes of the trade. There was no finding of misconduct and the payment was for the use of information obtained, not for the possession of that information. Further, the penalty was a "deterrent", as opposed to a personal punishment of the company. There was no element of public protection as there were no safety issues in point.

Q The result

A The decision was released on 7th September, with the First Tier Tribunal deciding in McLaren's favour – just. Two judges heard the case, one of whom found for HMRC and the other (with the casting vote) finding for McLaren.

The decision states that whilst the activities that gave rise to the penalties were not a normal part of the trade, they were closely associated with the mainstream of the trade. The penalty was a commercial penalty for a commercial activity – not one which protected the public, or penalised the company "personally". If the company did not carry on the trade it did, the penalty would not have arisen.

As such, the deduction was allowable for tax purposes.

Q What next …?

A This was a decision that HMRC will not have expected, and it seems highly likely that they will appeal it.

However, the decision (currently) gives scope for greater consideration as to whether relief may be available for non-criminal fines or penalties.

For further information on any of the above …
Catherine can be contacted on 01642 632032 or email cs@bainesjewitt.co.uk

UK200Group Tax Panel members are renowned for their depth of knowledge and can advise on all areas of taxation with special expertise and experience of multinationals, UK companies, privately-owned organisations, sole traders, family businesses, trusts, partnerships and private individuals. Straight forward general enquiries will be dealt with quickly and free of charge. More complex specific client enquiries may require a fee charge which will be discussed and agreed by both parties prior to any work being undertaken.

Tax enquiries can be posted to www.uk200group.co.uk members' home page under member's queries. The Centre is alerted to all enquiries posted on the UK200Group web site.

1 Capital Gains Tax
2 Sales & Acquisitions
3 Employee Share Incentives
4 Inheritance Tax
5 International Tax
6 Offshore Tax Planning
7 Partnership Tax Planning
8 PAYE and NI
9 Stamp Duty Land Tax
10 Tax Investigations
11 Taxation of Owner Managed Businesses
12 Trusts
13 UK Taxation of Foreign Expatriates
14 VAT

Alastair Byrne 1, 2, 11
JWPCreers LLP
York, 01904 624155
ajb@jwpcreers.co.uk
www.jwpcreers.co.uk

Alan Boby 1, 2, 3, 4, 8, 11, 12
Ellacotts LLP
Banbury, 01295 250401
aboby@ellacotts.co.uk
www.ellacotts.co.uk

Mhairi Charlton 2, 3, 8, 10, 11
Anderson Barrowcliff LLP
Middlesbrough, 01642 660300
mhairi@anderson-barrowcliff.co.uk
www.anderson-barrowcliff.co.uk

Martin Culshaw 2
Hillier Hopkins LLP
Watford, 01923 232938
martin.culshaw@hhllp.co.uk
www.hillierhopkins.co.uk

Stephen Deutsch 1, 2, 3, 7, 8 9, 11
BKL Tax
London N3, 020 8922 9119
Stephen.deutsch@bkltax.co.uk
www.bkltax.co.uk

Mike Donnan 1, 2, 7, 8, 11
Howard Worth
Northwich, 01606 369000
mikedonnan@howardworth.co.uk
www.howardworth.co.uk

John Dormer 3, 8
Wright Hassall LLP
Leamington Spa, 01926 886688
john.dormer@wrighthassall.co.uk
www.wrighthassall.co.uk

Debra Dougal - Chairman 14
Haslers
Loughton, London NE, 020 8418 3426
Debra.dougal@haslers.com
www.haslers.com

David Gillies 4, 5, 6, 12 ,13
Harwood Hutton Ltd
Beaconsfield, 01494 739500
davidgillies@harwoodhutton.co.uk
www.harwoodhutton.co.uk

Andrew Jackson 1, 2, 5
Fiander Tovell LLP
Southampton, 023 8033 2733
andrewjackson@fiandertovell.co.uk
www.fiandertovell.co.uk

Barry Jefferd 1, 2. 3, 4, 7, 8,
George Hay Partnership LLP
Huntingdon, Cambridgeshire, 01480 426500
barry.jefferd@georgehay.co.uk
www.georgehay.co.uk

Terry Jordan 4, 12
BKL Tax
London N3, 020 8922 9360
terry.jordan@bkltax.co.uk
www.bkltax.co.uk

Chris Mattos 1, 2, 3, 6, 7, 9, 10, 11, 12,
Randall & Payne LLP
Stroud, 01453 763471
cjm@randall-payne.co.uk
www.randall-payne.co.uk

Chris Mattos 1, 2, 3, 6, 7, 9, 10, 11, 12,
Randall & Payne LLP
Stroud, 01453 763471
cjm@randall-payne.co.uk
www.randall-payne.co.uk

Duncan Montgomery 1, 2, 4, 7, 9, 11, 12
Whittingham Riddell LLP
Shrewsbury, 01743 273273
dmontgomery@whittinghamriddell.co.uk
www.whittinghamriddell.co.uk

Clare Munro 1, 2, 3, 4, 5, 10, 11, 12
Haslers
Loughton, London NE, 0208 418 3333
clare.munro@haslers.com
www.haslers.com

Robert Postlethwaite 3
Postlethwaite & Co Solicitors
London WC2, 020 7470 8805
rmp@postlethwaiteco.com
www.postlethwaiteco.com

Graham Purvis 1, 3, 4, 7, 11, 12
Robson Laidler LLP,
Newcastle upon Tyne, 0191 281 8191
gpurvis@robson-laidler.co.uk
www.robson-laidler.co.uk

Continued over …

UK200Group Tax Panel members are renowned for their depth of knowledge and can advise on all areas of taxation with special expertise and experience of multinationals, UK companies, privately-owned organisations, sole traders, family businesses, trusts, partnerships and private individuals. Straight forward general enquiries will be dealt with quickly and free of charge. More complex specific client enquiries may require a fee charge which will be discussed and agreed by both parties prior to any work being undertaken.

Tax enquiries can be posted to www.uk200group.co.uk members' home page under member's queries. The Centre is alerted to all enquiries posted on the UK200Group web site.

Panel membership continued ...

Derek Rhodes 6, 12
Alex Picot Ltd (International Associate)
St Helier, Jersey 01534 753753
derek.rhodes@alexpicot.com
www.alexpicot.com

Catherine Scott 2, 10, 11
Baines Jewitt LLP
Stockton on Tees, 01642 632032
cs@bainesjewitt.co.uk
www.bainesjewitt.co.uk

Doug Sinclair 10
BKL Tax
London N3, 020 8922 9328
doug.sinclair@bkltax.co.uk
www.bkltax.co.uk

Anne Smith 1, 2, 3, 4, 5, 8, 9, 11, 12, 13,
Watts Gregory LLP
Cardiff, 029 2054 6600
a.smith@watts-gregory.co.uk
www.watts-gregory.co.uk

Marcus Ward 14
Price Bailey LLP
Cambridge, 01223 696114
marcus.ward@pricebailey.co.uk
www.pricebailey.co.uk

David Whiscombe 1, 2, 3, 5, 6, 7, 8, 9, 10, 11, 13
BKL Tax
London N3, 020 8922 9306
david.whiscombe@bkltax.co.uk
www.bkltax.co.uk

Francis Whitbread 1, 2, 3, 4, 7, 11, 12, 14
Edmund Carr LLP
Chelmsford, 01245 261818
fwhitbread@edmundcarr.com
www.edmund-carr.co.uk

Disclaimer

UK200Group is an association of separate and independently owned and managed accountancy firms and lawyer firms. UK200Group does not provide client services and it does not accept responsibility or liability for the acts or omissions of its members. Likewise, the members of UK200Group are separate and independent legal entities, and as such each has no responsibility or liability for the acts or omissions of other members.