Entrepreneurs' relief: exclusion of goodwill in certain circumstances

Entrepreneurs' relief in respect of goodwill has been withdrawn where an individual, trustee, or member of a partnership transfers their business to a close limited company in relation to which they are a "related party".

Who should read this?

Individuals, trustees and members of partnerships who are considering incorporation or a sale of their business to a close limited company in which they will be a shareholder.

Summary of measure

Where an individual, trust or partner transfers their business to a close limited company to which they are a "related party" (for example, on incorporation), Entrepreneurs' relief is no longer available in respect of goodwill transferred.

The term "related party" is defined as a participator or associate of a participator in a close company. This broadly means anyone with a share or interest in the capital or income of the company or their spouse/civil partner, parent/child or remoter, brother/sister or partner. The legislation will apply to transfers to both UK close limited companies and non-UK resident companies who would be categorised as a close company if they were resident in the UK.

The restriction does not apply to retiring partners who are not participators in the transferee company, provided there are not any arrangements under which they may become one. In addition, their only connection with the actual participators of the company is that of partner in the business being transferred to the company. The explanatory notes do make it clear, however, that the retiring partner can perform services for the business, for example as a consultant.

Anti-avoidance provisions are also included in the legislation to capture those who are party to relevant avoidance arrangements.

This change has been made alongside a measure to restrict corporation tax deductions under the intangible asset regime where goodwill and other intangible assets are acquired from related party individuals. This will only apply to close companies making acquisitions from their individual participators.

Timing

The legislation relating to the restriction of goodwill applies to consideration received in the form of cash or debt in respect of disposals of goodwill on or after 3 December 2014.

Our view

This measure has been introduced to remove an advantage for the owners of unincorporated businesses who were able to crystallise the value of internally generated goodwill via a transfer to a related company in return for cash or debt that they could then potentially extract at the 10 percent

CGT rate, effectively converting a future income stream into capital. This measure has no impact on other capital gains tax reliefs available on incorporation.

Businesses looking to incorporate therefore need to consider the consequences of this measure.

The removal of 'retiring partners' from the restriction means that those genuinely selling their business can continue to benefit from entrepreneurs' relief.

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