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Section 30 Finance Act 2017: Further Restrictions on CGT Reliefs

Introduction

Section 30 of Finance Act 2017 has introduced certain anti-avoidance provisions to ss597AA (revised entrepreneur relief), 598 and 599 (retirement relief) TCA 1997, which essentially restrict the ability to claim these reliefs in connection with certain transactions involving disposals of goodwill, or shares or securities in a company, to another company. The measures apply to disposals on or after 2 November 2017, the date of publication of the Committee Stage amendments to the Finance Bill.

This article seeks to analyse the provisions by, firstly, looking at the "mischief" targeted by the measures; secondly, addressing the specific impact of the changes to entrepreneur relief and retirement relief; and, thirdly, focusing on the "safe-harbour" provisions included in the new section.

What Is the Mischief?

What is clear from the content of the measures is a policy that:

- individuals disposing of goodwill to companies with which the transferor remains connected should not obtain the benefit of entrepreneur relief or retirement relief and
- individuals disposing of shares in a company to another company where the transferor is connected with the first company should also not obtain the benefit of entrepreneur relief or retirement relief

unless it would be reasonable to consider that the disposals were for bona fide commercial reasons and not for the avoidance of tax.

Examples of Transactions within Scope of s30 FA 2017

Examples of transactions that might fall within the scope of the provisions follow.

Example 1

James has carried on a successful trade as an unincorporated trader for 10 years up to January 2018. Due to the level of profits, he is considering incorporating his business as corporate tax rates would allow him to maximise the amount of profits available for reinvestment in the business and expand his business with greater effect. He intends to take the bulk of the consideration by way of shares in the company, but a small proportion might need to be taken in cash to pay certain debts of the business. It had been suggested to him that entrepreneur relief or retirement relief should be available in relation to the cash taken by him. He will seek relief under s600 TCA 1997 to the extent that the consideration is taken by way of shares in the new company.

Section 30 of FA 2017 will now mean that the cash consideration will not qualify for entrepreneur relief or retirement relief, as James remains connected with the company to which the business has been transferred, unless it would reasonably be considered that the disposal was made for bona fide commercial reasons and not for the avoidance of tax.[1]

Additionally, if James seeks to claim relief under s600 TCA 1997, the cash consideration will not qualify for entrepreneur relief or retirement relief, whether or not he remains connected with the company to which the business has been transferred, unless the bona fide commercial/no avoidance of tax reasons can be shown.[2]

The application or otherwise of the safe-harbour/motive test provisions is discussed later in this article.

Example 2

Andrew has for some years carried on a successful trading business through a company, Drew Ltd, which is 100% owned by him. In January 2018, when aged 66, Andrew is considering that he might transfer 40% of his shares in Drew Ltd to a company owned by his daughter, Emily, for cash, a proposal suggested by Emily. The arrangements would allow for the transferee company to obtain the remaining 60% at any time over the following three years for market value, to be assessed on the basis of profits. Andrew is happy to run with the proposal as it provides a means to manage the business succession in stages and allows him to have a partial exit and potentially obtain entrepreneur relief or retirement relief on cash received. He will remain involved in the business and, although he has not mentioned this to Emily yet, he intends to transfer his remaining shares to her by

1 Section 597AA(2)(b)(iv) TCA 1997 (as inserted by s30(1)(a)(iii) FA 2017) and s598(1) TCA 1997 (definition of chargeable business asset) (as inserted by s30(2)(a) FA 2017).

2 Section 597AA(6) TCA 1997 (as inserted by s30(1)(b) TCA 1997) and s598(7C) TCA 1997.

way of a gift in three years' time as he would be sure of her intentions in relation to continuing the business.

The provisions of s30 Finance Act 2017 will have the effect of denying Andrew entrepreneur relief and retirement relief on the transfer if it would not be reasonable to consider that the disposal was made for bona fide commercial reasons and not for the avoidance of tax.[3]

Example 3

Following on from Example 2, in January 2021 Andrew has seen enough evidence of Emily's ability and wishes to proceed with the transfer of the remaining 60% to her. He intends to make the gift directly to her and not to her company. The expectation is that the gift of the 60% of the shares would qualify for retirement relief from capital gains tax (CGT) under s599 TCA 1997.

By virtue of the FA 2017 changes to s599, if Andrew claims retirement relief on the transfer of the 40% of his shares in January 2018, then the consideration received in January 2021 will be aggregated with the market value of the 60% passing by way of a gift.[4] The effect of this aggregation will be to limit any retirement relief for Andrew on the disposal in January 2018 where the aggregate consideration arising under both disposals exceeds €500,000. This is irrespective of whether the initial disposal was excluded from the ambit of retirement relief by s30 FA 2017.

As with all anti-avoidance provisions, the law of unintended consequences applies and examples of unfairness will arise, as arguably is the case in Example 3. Happily, safe-harbour provisions are built into s30 that negate the harsher effects of the provisions, but as with all bona fide commercial test situations, interpretation will be critical.[5] These provisions are examined in greater detail below and are summarised in an Appendix to this article.

Entrepreneur Relief: Changes in Detail

Outline of entrepreneur relief

The so-called revised entrepreneur relief was introduced in FA 2015 and essentially provides for a reduced CGT rate of 10% on chargeable gains accruing on the disposal of the whole or a part of chargeable business assets by a relevant individual. The amount of chargeable gain that can obtain the benefit of the reduced 10% rate is capped at €1m.

Section 30 restrictions

The amendments made by s30 FA 2017 to s597AA TCA 1997 are as follows.

Exclusion of assets from "chargeable business assets"

Sub-section (2)(b) of s597AA lists a number of items that will not constitute "chargeable business assets" for the purposes of the reduced rate, and this list has been extended to include:

- goodwill transferred to a company where, after the disposal, the individual is **connected** with the company and
- shares or securities in a company ("Company 1") disposed of to another company ("Company 2") where, after the disposal, the individual is **connected** with Company 1.

3 Section 597AA(2)(b)(v) TCA 1997 (as inserted by s30(1)(a)(iii) FA 2017) and s598(1) TCA 1997 (definition of chargeable business asset) (as inserted by s30(2)(a) FA 2017).

4 Section 599(7) TCA 1997 (as inserted by s30(3)(b) FA 2017).

5 These safe-harbour provisions do not extend, however, to the amendments made to s599 TCA 1997.

In assessing whether the individual is connected in either case, the connected-party rules in s10 TCA 1997 will apply. A few comments might be noted in this regard:

- An individual will be connected with a company where either he or she controls the company or where he or she **and** a connected party control the company. Connected parties generally include relatives but can also include partners or trustees of certain settlements, so if the individual and relatives have control, connection will exist.
- The control of the company by persons connected but where the individual does not himself or herself have a shareholding should not be caught by the provisions.

The exclusion of the relief in the circumstances above is also subject to the safe-harbour/bona fide commercial test, discussed further below.

Avoidance of connection

A new sub-section is introduced to entrepreneur relief to confirm that where a relevant individual enters into arrangements having the purpose or main purpose of ensuring that the relevant individual is not connected with a company (to avoid the new connected-party provisions introduced by s30), the reduced rate is not to apply. It would appear that this provision is intended to counteract any contrived action.

Transfer of goodwill to company where s600 relief claimed

Where transfers of any assets occur **that form part of a transfer to which s600 TCA 1997 relief applies**, any consideration received other than by way of shares or securities in respect of the transfer to which s600 applies may no longer obtain the benefit of entrepreneur relief. This is subject to the bona fide commercial test, discussed further below.

An important point in this regard is that for the exclusion of entrepreneur relief to apply where s600 relief is being claimed, it is not necessary for the individual making the disposal to be connected with the transferee after the disposal or for the individual to actually claim s600 relief himself or herself (as long as the transfer of assets by him or her forms part of an overall transfer in respect of which s600 relief is claimed by another). The impact of this is, of course, that, absent the safe-harbour provisions applying, any transaction involving a disposal of assets under which s600 relief is being claimed will not qualify for relief.

Additionally, in the context of partnerships, one point to note, in the authors' view, is that where there is an incorporation of a partnership involving the transfer of a business under which one partner takes cash and the others shares (claiming s600 relief), the claim by the others to the relief will apply the new provisions to the partner taking cash.

Safe-harbour provisions

Provisions have been incorporated stating that the new exclusions from relief referred to above do not apply:

> "where it would be reasonable to consider that a disposal…is made for bona fide commercial reasons and does not form part of any arrangement or scheme the main purpose or one of the main purposes of which is the avoidance of liability to tax".

The particular safe harbour that applies in relation to the new provisions is explored in detail below, as the wording introduced to the entrepreneur relief provisions is mirrored in the changes to retirement relief.

In Summary

The inclusion of a safe-harbour test, which disapplies the new provisions where it would be reasonable to consider that the disposal was made for bona fide commercial purposes and not for the avoidance of tax, means that the application of the provisions may not be as widespread as first thought. However, the general rule is now that transactions involving disposals of goodwill, shares or securities, and transfers under which s600 relief is claimed, and which are not made for bona fide commercial reasons, will now be excluded from the reduced rate of CGT under s597AA TCA 1997.

Retirement Relief: Changes in Detail

Section 30 incorporates amendments to ss598 and 599 TCA 1997, which provide for retirement relief.

Changes to ss598 TCA 1997

The changes to s598 are almost identical in scope to those made to s597AA.

Exclusion of assets from "chargeable business assets"

In the definition of "chargeable business assets" for the purposes of the relief, the assets not included have been extended to cover:

- goodwill transferred to a company where, after the disposal, the individual is **connected** with the company and
- shares or securities in a company ("Company 1") disposed of to another company ("Company 2") where, after the disposal, the individual is **connected** with Company 1.

In assessing whether the individual is connected in either case, the connected-party rules in s10 TCA 1997 will apply. A few comments might be noted in this regard:

An individual will be connected with a company where either he or she controls the company or he or she **and** a connected party control the company. Connected parties generally include relatives but can also include partners or certain settlements, so if the individual and relatives have control, connection will exist. The control of the company by persons connected but where the individual does not himself or herself have a shareholding should not be caught under the provisions.

Provisions have been incorporated stating that the above do not to apply "where it would be reasonable to consider that a disposal…is made for bona fide commercial reasons and does not form part of any arrangement or scheme the main purpose or one of the main purposes of which is the avoidance of liability to tax".

Avoidance of connection

A new sub-section (7C) is introduced to s598 TCA 1997 – similar to entrepreneur relief – to confirm that where a relevant individual enters into arrangements having the purpose or main purpose of ensuring that the relevant individual is not connected with a company (to avoid the new connected-party provisions introduced by s30), retirement relief is not to apply.

Transfers of goodwill to company where s600 relief claimed

Where transfers of any assets occur **that form part of a transfer to which s600 TCA 1997 relief applies**, any consideration received other than by way of shares or securities in respect of the transfer to which s600 applies may no longer obtain the benefit of retirement relief. This is subject to the bona fide commercial test, discussed further below. The points made above in relation to the entrepreneur relief changes relevant to s600 cases will equally apply in this case.

Safe-harbour provisions

Although the inclusion of a bona fide commercial test in the context of entrepreneur relief, where such a test was not required to be met previously, makes some sense, the inclusion of this test in s598 TCA 1997 may not. Relief under s598 was already not available unless the disposal was carried out for bona fide commercial purposes and not for the purpose of avoiding tax.

There is now, therefore, a dual bona fide commercial test that must be satisfied by any individual claiming retirement relief in the circumstances coming within the new provisions. Firstly, if we take the example of a transfer of goodwill to a company with which the person making the disposal is connected, there is the need to show that the disposal could reasonably be categorised as effected for bona fide commercial reasons and not for the avoidance of tax. Secondly, where the first test is met, there is the further requirement to meet the bona fide commercial test in sub-section 598(8).

The author wonders as to the rationale/necessity for a dual test and indeed its effect. Perhaps the answer is "none" in both cases, as in the authors' view, as in both cases and there is no intended change in the meaning or application. Perhaps all that was intended was to present a belt-and-braces position on the specific disposals targeted by s30 FA 2017.

Section 599 TCA 1997

In relation to s599, which provides for retirement relief on certain disposals of qualifying assets to children or favourite nephews or nieces, changes are introduced that are, oddly enough, restricted to transfers or disposals of chargeable business assets by persons aged 66 or over. For such disposals, relief under s598 was already reduced to €500,000 in respect of chargeable consideration, and there is also a cap on the value of chargeable business assets for the purposes of s599.

Section 30 of Finance Act 2017 amends s599 by essentially providing that where an individual aged 66 or over makes a disposal of shares or securities of a family company to a child **and** makes a disposal of shares or securities of the family company to a company controlled by that child, the consideration in respect of both transfers is aggregated for the purposes of assessing the retirement relief limit of €500,000 in s598(3).

There is no bona fide commercial test in respect of this amendment.

A few points might be noted in relation to this provision:

- The application of this amendment to transfers of chargeable business assets by individuals aged 66 or over does not appear to have any clear policy attaching. It therefore presents a trap for the unwary in such transactions.
- The aggregation provisions appear to apply even where the disposal of the shares in the family company to the child did not qualify for relief under s599(1). Although it is difficult to see how that might arise in practice, it should be noted.
- The aggregation provisions similarly apply even where relief under s598 has applied (notwithstanding the s30 changes) and the motive test has been met under that section. To penalise further appears to make little sense.
- Given the commencement date of the section, 2 November 2017, it would appear that the aggregation provisions should **not** have effect where either of the two disposals occurred before that date. This is however, not stated in the legislation, but appears to be the more correct approach, in the author's view.

Bona Fide Commercial Test/Motive Test

A safe-harbour motive test is introduced to provide safeguards for transactions caught within s30 FA 2017 (excepting the s599 TCA 1997 changes). The wording in this motive test differs somewhat from the normal form of motive test in that it incorporates "where it would be reasonable to consider" as the standard of assessment. To determine the extent of the motive test, it is necessary to consider this wording first, before considering the motive test more generally.

"Where it would be reasonable to consider"

In recent years it has become more common for tax provisions to incorporate the wording "where it would be reasonable to consider", particularly anti-avoidance provisions. See, for example, the terms of s811C TCA 1997 on the question of when a transaction will be a tax-avoidance transaction. The wording would appear to allow the incorporation of some public law/administrative law standard of reasonableness in the decision-making process of Revenue particularly on anti-avoidance matters.

In particular, where the application or otherwise of certain tax provisions by Revenue

involves an element of discretion, the use of such wording, which is more common in relation to administrative discretions outside of the taxation arena, allows a common-sense approach to be taken in the context of decisions by Revenue. This is important, as Revenue decisions, just like those of any public body, are reviewable by the courts under judicial review mechanisms, and the onus of overturning such a decision is quite high.

What can be gleaned from administrative case law is that the question of whether "it would be reasonable to consider" something as being such requires the application of a reasonable approach and common sense.[6] The corollary of that, of course, is that for the motive test not to apply, the position must fly in the face of common sense.

Whereas the more usual wording associated with taxation motive tests is subjective, it would appear that this wording makes the motive test more objective, in that the actions of the person making the disposal are to be assessed objectively to consider whether the disposal was made for bona fide commercial reasons and not for the main purpose or one of the main purposes of the avoidance of liability to tax. However, a number of questions will fall to be considered in light of the particular wording.

As the "saver" against the new provisions applying requires satisfaction of the motive test where it can be reasonably considered to be satisfied, who is the person who must assess whether it is reasonable to consider that the motive test is satisfied in the first instance? Is it Revenue or the taxpayer? It would appear to be logical that it is the taxpayer, and if so, the overturning of a reasonable opinion of the taxpayer would appear to require the taxpayer's reasonable opinion to fly in the face of common sense on an objective basis. This is a standard that has been laid down in administrative decisions.

In a situation where Revenue takes the view that the "saver" should not apply – essentially holding that it could not reasonably be considered that the motive test is met – what recourse does a taxpayer have to challenge this view? Logically, it should be by appeal to the Tax Appeals Commission, as the impact will be one of quantum.

Bona fide commercial test and not for the avoidance of tax

In relation to the main motive test, the seminal case of *Duke of Westminster v CIR*[7] was heard back in the 1930s. The judgment of Lord Tomlin contained the following words, which still have a bearing on the question of whether actions constitute tax avoidance or tax mitigation today: "Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it would otherwise be." This *dictum* has been followed in Irish case law right down to the *McGrath*[8] case.

In distinguishing between tax avoidance and tax mitigation, the courts in the UK found that:

> "The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any such taxpayer's qualifying for a reduction in his tax liability. The hallmark of tax mitigation on the other hand is that the taxpayer takes advantage of a fiscally attractive option offered to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option."[9]

In assessing whether tax avoidance is involved, the courts, particularly in the UK, have provided significant guidance on when it will be considered that a transaction was carried out

6 *NM (DRC) v The Minister for Justice, Equality and Law Reform* [2016] IECA 217.
7 [1936] AC 1.
8 [1988] IR 258.
9 *IRC v Willoughby* [1997] STC 995.

for bona fide purposes and not for the main purpose of avoiding tax.

In the case of *Fisher v HMRC*[10] the UK First-tier Tribunal (FTT) gave a lengthy judgment on the application of the UK legislation on the transfer of assets abroad. Although it is an FTT decision, it contains an extensive analysis of the principles concerning tax avoidance and the main-purpose test. The following *dictum* of Upjohn J in *IRC v Brebner* was cited:

> "My Lords, I would only conclude my judgment by saying, when the question of carrying out a genuine commercial transaction, as this was, is considered, the fact that there are two ways of carrying it out – one by paying the maximum amount of tax, the other by paying no, or much less, tax – it would be quite wrong as a necessary consequence to draw the inference that in adopting the latter course one of the main objects is, for the purposes of the section, avoidance of tax. No commercial man in his senses is going to carry out commercial transactions except upon the footing of paying the smallest amount of tax involved."[11]

In effect, the FTT noted that taking a lower tax rate in itself does not imply that one of the main objects is tax avoidance; however, tax avoidance may not be precluded. This is, of course, relevant where a transaction is being effected in a particular way to achieve a reduced rate of tax through, say, entrepreneur relief.

Revenue in its guidance notes states that where the tax advantage is "simply the icing on the cake", it will not be a primary or main purpose. This extract was pulled from the decision of Lightman J in the case of *CIR v Sema Group Pension Scheme Trustees.*[12] However, it is useful to read more fully from that extract, which has been cited with approval in a number of other cases:

> "Obviously if the tax advantage [arising from the transaction] is mere 'icing on the cake' it will not constitute a main object. Nor will it necessarily do so merely because it is a feature of the transaction or a relevant factor in the decision to buy or sell. **The statutory criterion is that the tax advantage shall be more than relevant or indeed an object; it must be a main object.** The question whether it is so is a question of fact for the Commissioners in every case [emphasis added]".

The UK FTT case of *Versteegh Limited v HMRC*[13] also contains detailed analysis of the main-purpose test. The judge in that case made the following comments in referring to *dicta* from the VAT Tribunal case of *Coffee Republic plc v HMRC*:[14]

> "In reaching its conclusions, the tribunal noted that there was a distinction between an inevitable result of the successful completion of a purpose and something which is necessary for or part of a stated purpose. The tribunal offered, at [54], the following analogy:
>
> > 'If with intent a person kills a fly by squashing it, it cannot be said that because his avowed purpose was "to kill the fly", it was not also to squash it. His purposes may stop short at the killing: his purpose of killing the fly by squashing does not mean that he had a purpose of leaving a mess on the window, but it must encompass the intended means of achieving the killing.'"

10 [2014] UKFTT 804 (TC).
11 [1967] 43 TC 705, 718–19.
12 [2002] 74 TC 593.
13 [2013] UKFTT 642 (TC).
14 [2007] UKVAT V20150.

The judge went on to state:

> "In our view, *Coffee Republic* does not support HMRC's argument. It points in the opposite direction. It suggests that, if the purpose of a borrower was to achieve tax avoidance by entering into [the transaction], it could be said that the borrower had a purpose of entering into the [transaction], because that was the means by which the tax avoidance purpose would be achieved. The tax avoidance purpose equates to the killing of the fly, and the [transaction] is the squashing [of] it. But the converse does not hold. The fact that a tax advantage is an inevitable consequence of the entry into the [transaction] does not mean that it is a purpose of the borrower, even if he knows that will be a consequence; the tax advantage is merely the mess on the window."

In summary, the case law and authorities on this subject demonstrate the following principles:

- In carrying out a genuine commercial transaction, and where there are two means of carrying it out – one with a greater tax charge than the other – the taking of the route with the lower tax charge does not mean that the tax avoidance/tax advantage was the main purpose.
- To avoid the tax advantage being a main purpose of the transaction, it is, however, not sufficient to point to a commercial purpose of the taxpayer. The existence of a commercial purpose does not preclude the existence of a main purpose of obtaining a tax advantage or avoiding liability to tax.
- Notwithstanding this, the tax advantage can be a relevant factor in the decision to proceed with the transaction and still not be a main purpose of the transaction. It must be more than just relevant to the transaction to be a main purpose.
- The fact that a tax advantage will be an inevitable consequence or likely outcome of the transaction does not mean that the obtaining of the tax advantage is a main purpose of the transaction.
- The question of whether the tax motive was a main purpose is one of fact.

Conclusion

The changes introduced in s30 FA 2017 will create a more restrictive regime for CGT reliefs in practice. In particular, the changes to entrepreneur relief will mean that individuals seeking the reduced rate of tax for such transactions will have to ensure that it can be shown that the transactions would reasonably be considered to have been for commercially motivated reasons and did not have tax avoidance as a main purpose. Taxpayers and practitioners will need to be familiar with Finance Act 2017 changes.

The focus on excluding transfers of goodwill from entrepreneur relief and retirement relief appears to represent a clear policy move to tackle what Revenue considers are abusive transactions to extract proceeds from companies through recognition of goodwill. The approach in s30 has, in recent weeks, been supplemented by eBrief No. 28/18, which provides some guidance on Revenue's views on recognition of goodwill.

Read more on taxfind From Irish Tax Institute *Direct Tax Acts, Finance Act 2017*

Appendix

Nature of disposal potentially impacted by s30 FA 2017	Retirement relief pre s30?	Retirement relief post s30?	Entrepreneur relief pre s30?	Entrepreneur relief post s30?
Transfer of goodwill by individual to company connected with individual	✓*	X**	✓	X**
Transfer of goodwill by individual to company where individual is **not** connected with the company	✓*	✓*	✓	✓
Transfer of shares in company to another company where individual remains connected with first company	✓*	X**	✓	X**
Transfer of shares in company to another company where, following disposal individual is **not** connected with first company	✓*	✓*	✓	✓
Non share (cash) consideration re s600 transfer	✓*	X**	✓	x
Aggregation of (1) transfer of shares to a child under Section 599 (2) transfer of shares to company controlled by that child by individuals aged 66 or over	Not aggregated	Aggregated	N/a	N/a

* *Bona fide commercial test still required to be met under s598(8) TCA 1997*

** *If new bona fide commercial test can be met, then transaction can still qualify for relief (in the case of retirement relief, there is a dual bona fide commercial test). Otherwise, relief not available.*