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Restriction to corporation tax relief for internally generated goodwill

Corporation tax relief is no longer available where a company acquires goodwill and other intangible assets from related individuals and partnerships.

Who should read this?

Companies who acquire internally-generated goodwill and customer related intangible assets from a "related party" including on a business transfer.

Summary of proposal

Corporation tax deductions under the intangible asset regime where goodwill and other intangible assets are acquired from related party individuals and partnerships has been restricted. This will only apply to close companies making acquisitions from their individual participators or partnerships who have an individual participator as a member.

The restriction applies to direct and indirect transfers but see below regarding the timing.

Prior to this, a deduction was allowed on the acquisition of goodwill, etc. created or acquired after 1 April 2002. Together with Entrepreneurs' Relief this created a 10 percent tax charge on the individual disposing of a business but obtained future corporation tax deductions on the same consideration. This benefit was not available to unincorporated businesses which were not transferred to a company or start-up businesses that had always been operated in a company.

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.

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 Entrepreneurs' Relief on the transfer of goodwill to a close limited company in relation to which they are a "related party".

Timing

The tax restriction applies to all direct transfers on or after 3 December 2014 unless made pursuant to an unconditional obligation entered into before that date. Where an accounting period commences before 3 December 2014, the accounting period is split so that this measure only applies to debits arising from the notional accounting period commencing on 3 December 2014.

The restriction was extended to indirect transfers with effect from 24 March 2015.

Our view

This measure has been introduced to remove an advantage for the owners of unincorporated businesses who were able to obtain a corporation tax deduction for the consideration paid in respect of internally generated goodwill. In addition, they could also crystallise the value of this via a transfer to a related company in return for cash or debt that they could then potentially extract at the 10% CGT rate, effectively converting a future income stream into capital.

When the measure was initially announced, the drafting of the legislation meant that there was a loophole as the rules only applied to a direct transfer – i.e. individual transfers to company A – company A is restricted. If however company A then transferred to company B, company B would not be restricted.

The "indirect" rule extends these provisions to company B with effect from 25 March.

Businesses looking to incorporate therefore need to consider the consequences of both this measure and the restriction of Entrepreneurs' Relief on goodwill and related transfers.

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