



Entrepreneurs' Relief

Introduction

Entrepreneurs' Relief was introduced in the 2008 Finance Act as the successor to Taper Relief. Taper Relief was well understood and gave a 10% rate of Capital Gains Tax ("CGT") in most cases with an allowance for indexation. ER on the other hand is not so easily understood with complex rules and more restrictions than under the Taper Relief regime.

Since its introduction, the tax specialists at Friend Partnership Limited have been advising clients on all aspects of the ER legislation and identifying the planning opportunities which are available.

This Briefing Note is an overview of the rules and aims to prompt some further thought and discussion.

The main elements of Entrepreneurs' Relief ("ER") are:

- If all the necessary conditions are met, an effective CGT rate of 10% will be available on qualifying disposals instead of the higher rates of 18% and 20%.
- ER is only available to individuals and the Trustees of life interest trusts.
- There is currently a lifetime limit of £10 million of qualifying gains.
- Only certain disposals qualify for ER.

Which disposals qualify for ER?

There are three classes of disposal that qualify for ER.

1. Material disposal of business assets

To qualify, a disposal must fall within one of the three categories below and all the detailed conditions must be met:

a) The disposal of the whole or part of a business

The business must be owned by the individual throughout the period of one year ending with the date of the disposal. The definition of a disposal of whole or part of a business is not straightforward. It should also be noted that for ER purposes a business includes an interest in a partnership, including a trading LLP. An ER claim cannot cover assets held as investments.

b) The disposal of assets used for the purposes of a business

The disposal of a business asset will only qualify for relief where:

- The business ceases;
- The business was owned by the individual throughout the period of one year ending with the date of cessation; and
- The date of the disposal is within the period of three years beginning with the date of cessation.

c) The disposal of shares in, or securities of, a company

The conditions are:

- The company is a trading company or the holding company of a trading group;
- The individual must be an officer or employee of the company or of another group company, and the company must be the individual's 'personal company';

- A personal company is one where the individual is the holder of at least 5% of the ordinary share capital, and can exercise at least 5% of the voting rights by virtue of that holding;
- The company and the individual must meet the above conditions throughout the period of one year ending with the date of the disposal; and
- These rules are modified where the company is being wound up.

The 5% shareholding condition is relaxed in respect of shares acquired on exercising Enterprise Management Incentive (“EMI”) qualifying options provided a year has passed since the option was granted and the individual has been an employee throughout that period.

Care is needed with regard to the foregoing conditions especially where family shareholdings are involved. Transferring shares between family members may be appropriate for certain tax purposes but the potential impact on ER should not be overlooked.

2. Disposal of Trust business assets

In limited circumstances Trustees can also benefit from a claim for ER.

The conditions to be met are:

- the disposal must be of shares in, or securities of, a qualifying beneficiary’s personal trading company, or assets used in a qualifying beneficiary’s business;
- a beneficiary must have an interest in possession, other than for a fixed term, in the Trust business assets; and
- the beneficiary has to have unused lifetime ER allowance and the beneficiary must agree to allow the Trustees to use the available lifetime ER allowance. Please note that the amount used by the Trustees reduces the amount available for the individual to use against future qualifying gains.

Where the Trustees own shares in a company, ER will only be available where the company is a trading company or the holding company of a trading group.

Please note that when looking at the conditions the percentage shareholding of the Trustees is irrelevant.

In view of the restricted nature of the ER available to Trustees care is needed. Advice should be sought where necessary and there may be some simple steps which can be taken to improve the position.

3. Associated disposals

To qualify for ER under this category, there must be both an 'associated disposal' and a 'relevant material disposal' that the associated disposal is connected with.

A relevant material disposal is:

- The disposal of the whole or part of the individual's interest in the assets of a partnership; or
- The disposal of shares in, or securities of, a qualifying company.

An associated disposal is the disposal of an asset held personally by the individual that was used either in the trade of the partnership or of the company. The associated disposal must be made as part of the withdrawal by the individual from participation in the business carried on by the partnership or by the company, or a group company.

The provisions are complicated and ER is restricted in certain cases, chiefly where the asset, or part of the asset, has not been used for business purposes throughout the period of ownership.

ER is also restricted where, for the whole or part of the period of business use, the availability of the asset was dependent on the payment of rent. This is especially relevant where a company's premises may be held personally by one of the company's shareholders. Typically rent may be paid as part of personal tax planning initiatives. This planning has to take in to account the loss of, or reduction in, ER.

Anti-avoidance

Targeted anti-avoidance rules were introduced for liquidation distributions on or after 6 April 2016.

The aim of the rules is to eliminate the practice of 'phoenixism' where a company is liquidated to secure the 10% CGT on the liquidation proceeds only for the same or similar activity to be continued in a new company.

The new rules will treat any distribution which falls foul of the legislation as dividend income and not a capital gain. This would result in a trebling of the tax liability.

There are various conditions which need to be met before the anti-avoidance rules apply.

HMRC have indicated that the rules will potentially apply to special purpose vehicles which are used for commercial reasons by property developers, film and theatre production companies and numerous other businesses.

This is unsatisfactory because there is no tax motive for the structures they use it is simply commercial necessity.

Accordingly, great care is needed when dealing with company liquidations.

How Friend can help

This Briefing Note has detailed the various conditions and restrictions which come in to play when looking at potential claims for ER. We can assist in a number of ways:

- Reviewing with you the ER status of your various assets;
- Advising you on actions you can take to improve the ER position of certain assets;
- Advising you of the pitfalls to be avoided which could lead to the partial or total loss of ER on a future disposal; and
- Reviewing with you any new business arrangements to ensure that they are set up in the most efficient manner for ER.



If you have any questions regarding this Briefing Note please contact:

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