

## CHANGES TO ENTREPRENEURS' RELIEF



**Entrepreneurs' Relief (ER) is a tax relief available on the disposal of a business. The 2018 Autumn Budget introduced some significant changes to ER, meaning that even closer attention to the rules will be needed to ensure eligibility. The focus in this factsheet is the company shareholder; ER is also available to unincorporated businesses.**

### A background to ER

ER gives access to a 10% rate of capital gains tax (CGT), subject to a lifetime limit of £10 million. It applies to gains on disposals of shares and securities in a 'trading' company, or holding company of a trading group. The definition of trading company is examined later in this factsheet.

ER can also apply to assets (such as land and buildings) used by a company but owned by an individual, if the assets disposed of are 'associated' with the withdrawal of the individual from participation in the company.

### Eligibility criteria

#### The new two-year rule

Ownership conditions apply throughout the period up to the date of disposal, and to access ER the period of ownership is critical. The qualifying period was previously 12 months, but the 2018 Autumn Budget extends this to 24 months for disposals on or after 6 April 2019.

#### Qualifying conditions

To qualify for ER, throughout the relevant qualifying period you must:

- hold at least 5% of the company's ordinary share capital; and
- be able to exercise at least 5% of the voting rights.

For disposals on or after 29 October 2018, you must also be beneficially entitled to at least:

- 5% of the company's distributable profits; and
- 5% of the assets available for distribution to equity holders in a winding up.

You must also be a company employee or office holder throughout the relevant qualifying period.

Although many factors may prompt a resignation in the run-up to a disposal, from friction among fellow director-shareholders, to pressure from prospective purchasers, directors should remain in office up to the date of disposal to avoid jeopardising an ER claim.

#### Trading companies

A trading company is defined as one 'carrying on trading activities whose activities do not to any substantial extent include activities that are not trading activities'. Trading activities are defined as those carried out by the company:

- in the course of, or for the purposes of, a trade being carried on by it
- for the purposes of a trade that it is preparing to carry on
- with a view to its acquiring or starting to carry on a trade
- with a view to its acquiring a significant interest in the share capital of another company that:
  - is a trading company or the holding company of a trading group; and
  - if the acquiring company is a member of a group of companies, is not a member of that group.

#### Substantial extent

What is meant by 'substantial' is not defined in the legislation and is thus potentially more contentious. HMRC's view is that the term means more than 20%, but that raises the question: 20% of what? Points such as the company's history; income from non-trading activities; and the asset base of the company would likely be taken into account. So, too, would expenses incurred, or time spent on company business by its officers and employees.

#### Beware non-trading activities

It should be noted that with regard to property businesses, ER is restricted to Furnished Holiday Letting businesses – something the legislation defines very precisely.

One problem in the 'non-trading' area can be where a trading company accumulates a large cash balance. Here it might need to be ascertained whether the holding of cash is an activity, and if so, whether it fails the 20% test.

William and his wife have run Gulliver's Builders Ltd successfully for 20 years. Deciding to retire, they retain within the company, and then let out, the last five properties built. Trade ceases at this point. The rental income is intended to provide for their retirement. From an ER perspective, however, this means the company no longer qualifies for ER once it stops trading.

## Liquidations

Relief, however, is available where there is a delay between the end of trading and disposal of shares. All 5% and officer/employee conditions must be met in the 24 months leading up to the end of trading and disposal of shares must take place within 12 months of cessation. This means distributions in 2017/18 will be treated as if they were made in 2016/17.

For entrepreneurs whose business is in the one-year qualifying period

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## Maximising relief

It is judicious to take stock periods into account if you were the company to be sold immediately. The value of the company is £10 million x the number of shareholders. The following points are suggested here: please contact us for advice on the above circumstances.

If you meet the basic ER requirements above, it's possible to add to your shareholding in the final 24 months, getting an additional benefit. Where shareholders are spouses or civil partners, last-minute planning has considerable potential.

Shares in Boulevard Breweries Ltd are owned by two husband-and-wife teams, Paul Taylor (40%) and Sarah Taylor (10%); and Robert Powell (40%) and Sally Powell (10%). Paul and Robert are company directors. Sarah and Sally do not work in the company; nor are they office holders.

An unexpected offer is made for Boulevard Breweries on the basis of a quick sale. As things stand, the men will qualify for ER on their shares, but their wives will not – they are not officers or employees and cannot be so for the 24-month qualifying period.

Here however, Sarah and Sally could consider transferring shares to their husbands, with the husbands making the disposal. This will only be of use up to a value of £10 million on each husband's disposal.

and civil partners to the business and as they can claim ER separately – critical they work for the company  
the possibility of an HMRC

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and share ownership  
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will be able to make an election, treat the shares as disposed of their shares and immediately reacquire them at their value just before dilution. To avoid an immediate CGT bill on this deemed disposal, a further election can be made to defer the gain until such time as the shares are actually sold. ER can then be claimed in its current form. Written into the small print is a stipulation that the issue of shares is part of a genuine commercial scheme to raise capital.

**Making the most of Entrepreneurs' Relief requires careful planning. Please contact us for further advice on how ER could affect your business.**