

UK Tax - Entrepreneurs' Relief

Entrepreneurs' Relief is a valuable tax relief which reduces the rate of capital gains tax (CGT) on an individual's disposals of qualifying business assets. Chargeable gains meeting the requirements of the relief are subject to tax at only 10%, compared to the standard CGT rates, making this a very valuable relief worth up to £1 million for higher and additional rate taxpayers.

An individual's qualifying gains for Entrepreneurs' Relief are subject to a lifetime limit of £10 million. It is therefore important to plan well in advance of a disposal so as to maximise the benefit of this relief.

Background

Entrepreneurs' Relief is available for gains realised by individuals, and by the trustees of certain settlements, on the disposal of qualifying business assets. Gains which fall within the lifetime limit are taxed at a 10% rate of CGT. Ordinarily, gains arising on or before 6 April 2016 for basic rate taxpayers were taxable at 18% and 28% for other taxpayers. For gains arising from 6 April 2016, the tax rate is reduced to 10% for basic rate taxpayers or 20% for higher and additional rate taxpayers and trustees. Gains related to residential property remain taxable at 18% or 28%.

Entrepreneurs' Relief includes a number of aspects which give rise to significant problems in its application.

Qualifying business assets

For the purposes of Entrepreneurs' Relief, the term 'business' means a trade, professional or vocation conducted on a commercial basis and with a view to the realisation of profits.

The relief is available where there is a 'material disposal of business assets', which includes the following:

The disposal of whole or part of a business

Gains arising are eligible for relief provided that the individual owned the business (either alone or in partnership) throughout the period of one year ending with the date of the disposal. Gains on shares and securities owned by the business, assets held as investments, and goodwill sold to a connected company are excluded from relief.

The disposal of an asset which was used for the purposes of a business at the time the business ceased to be carried on

The business must have been owned by the individual (either alone or in partnership) throughout the period of one year ending with the date of cessation, and the disposal has to take place on or before the third anniversary of that date. Gains on shares and securities, and assets held as investments are, again, excluded from relief.

The disposal of shares or securities in a company which is, or was, a trading company or the holding company of a trading group

Throughout the period of one year ending with the date of the disposal the individual must have:

- held at least 5% of the ordinary share capital in the company;
- been able to exercise at least 5% of the voting rights in the company by virtue of that holding; and
- been an officer or employee of the company or, in the case of a holding company, of one or more companies which are members of the group.

If the company has ceased to be a trading company or the holding company of a trading group, these conditions must be satisfied throughout the period of one year ending with the date of cessation, and the disposal must take place on or before the third anniversary of that date.

The disposal of shares acquired through the exercise of EMI options

From 6 April 2013, shares acquired on exercising a qualifying Enterprise Management Incentive (EMI) option within 10 years of the option being granted may qualify for Entrepreneurs' Relief despite the individual not having a 5% holding and the shares (rather than the option to acquire them) not having been owned for 12 months.

To qualify for Entrepreneurs' Relief, the EMI option grant date (not the exercise date) must be at least one year before the date of disposal of the shares, and throughout that one-year period, the individual must have been an officer or employee of the company. The company must also have been either a trading company or a holding company of a trading group.

Entrepreneurs' Relief is also extended to disposals taking place within three years of the company ceasing to be a trading company. The individual must have acquired the shares before the trade ceased, and the option must have been granted at least a year before the date of

cessation of trade. Throughout that one year period, the company must have been either a trading company or a holding company of a trading group, and the individual an officer or employee of the company.

The disposal of trust business assets

Entrepreneurs' Relief must be claimed jointly by the trustees and the qualifying beneficiary on the disposal of:

- shares or securities in a trading company or the holding company of a trading group; and
- assets which are, or have been, used for the purposes of a business.

To be eligible for relief, an individual beneficiary of the trust must have an interest in possession (other than for a fixed term) in the shares or securities or the business assets. In addition, in relation to a disposal of shares or securities, the individual must have satisfied the conditions set out above regarding the ownership of ordinary share capital, voting rights and the holding of an office or employment throughout a period of one year ending not earlier than three years before the disposal. In relation to a disposal of business assets, the assets must be used for the purposes of a business carried on by the beneficiary (either alone or in partnership) throughout the period of one year ending not earlier than three years before the date of disposal. The beneficiary must cease to carry on the business on the date of disposal or within the period of three years before that date. Relief is given on the beneficiary's proportionate interest in the trust assets.

Whether relief can be claimed by trustees is determined by reference to the lifetime limit available to the individual. Disposals made by trustees are aggregated with disposals made by the individual in determining whether the individual has reached that limit.

Associated disposals

An individual may claim Entrepreneurs' Relief in respect of an associated disposal on:

- a disposal of the whole or part of their interest (at least 5%) in the assets of a partnership, or a disposal

of shares in, or securities of, a company which qualifies for relief (the 'material' disposal) as above;

- a disposal made as part of the withdrawal of the individual from participation in a business carried on by a partnership or company (or by a group company);
- the asset disposed of is used for the purposes of the business throughout the period of one year ending with the earlier of the date of the material disposal and the cessation of the business of the partnership or company.

Relief on an associated disposal is restricted if the asset has not been used for business purposes throughout the period of ownership, if only part of it has been used for business purposes, if the individual was involved in the business for only part of the period of business use, or if rent was paid by the business for use of the asset.

Additional considerations

The 2016 Finance Bill proposes changes to the legislation on associated disposals which mean the requirement to dispose of at least 5% of the individual's interest does not need to be met in certain cases.

The same Bill also proposes changes to the restriction on claiming relief on the disposal of goodwill to a connected company, but again only in certain cases.

Investors' Relief

The Finance Bill 2016 effectively extended Entrepreneurs' Relief to gains on certain disposals of ordinary shares in unlisted trading companies made by investors who are not employees or officers of the company, where the shares have been held for at least 3 years from 6 April 2016.

For the relief to apply the shares must be newly issued for consideration on or after 17 March 2016. For further information on Investors' Relief, please refer to our separate factsheet.

Planning

In view of the detailed conditions which have to be met, it is essential to plan in advance to maximise the gains qualifying for Entrepreneurs' Relief.

In addition to general planning, the legislation offers several specific opportunities. For example, each individual is entitled to their own lifetime limit. Accordingly, an individual could transfer assets to their spouse, on a tax-free basis, so that the spouse's lifetime limit could be used on a subsequent disposal. The transfer would need to be made sufficiently in advance of the disposal to enable the spouse to meet the ownership conditions.

Another example relates to the disposal of shares on a share-for-share exchange. Normally such an exchange is treated as not giving rise to a disposal for CGT purposes. However, the shares disposed of might qualify for Entrepreneurs' Relief but those acquired might not. Therefore, it is possible to elect to disapply the share-for-share exchange provisions so that there is a disposal on which Entrepreneurs' Relief can be claimed.

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