

Entrepreneurs' Relief

Entrepreneurs' Relief (ER) reduces the rate of UK Capital Gains Tax (CGT) on certain disposals to 10%. ER replaces Business Asset Taper Relief however is much more restrictive in its application. In addition, there is a lifetime cap on the value of qualifying gains that can benefit from ER, now set at £5 million.

For a disposal to qualify, it must come within one of three tightly drawn categories and the qualifying conditions have to be met continuously for a year in advance.

ER can only be claimed by individuals or through a joint claim made by a qualifying beneficiary and the trustees of a life interest trust. Corporate entities cannot claim ER.

ER gains can impact on the tax rate applicable to non-qualifying gains where an individual's total taxable income is less than the income tax basic rate band. This is because ER gains are deemed to use up any spare basic rate band in priority to other gains, meaning it is more likely that the 28% rate will apply to the other gains, rather than 18%.

Which disposals qualify for ER?

In general terms, there are three mutually exclusive qualifying disposal categories. For the purposes of ER, a business includes an interest in a partnership (with a trading Limited Liability Partnership being subject to the same rules as a standard partnership). An ER claim on the disposal of the whole or part of a business or business assets cannot cover investment assets.

Qualifying category 1 – material disposal of business assets

Broadly, to qualify, a disposal must fall within one of three sub-categories.

- a 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 and we would be pleased to advise in this area.
- b Disposal of (or of interests in) assets in use for the purposes of the 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 Disposal of (or of interests in) shares in or securities of a company
Shares or securities will only qualify for ER where the company is a trading company or the holding company of a trading group. In addition, the individual must be an officer or employee of the company and the company must be the individual's personal company. A company will only qualify as the personal company of an individual 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.

To qualify for ER on the shares or securities, the company and the individual must generally meet the above conditions throughout the period of one year ending with the date of the disposal.

There are variations to this rule where the company is being wound up or where it leaves a trading group. We can advise on these situations.

Qualifying category 2 – disposal of settlement business assets

Trustees can also benefit from ER, but only in limited circumstances. In broad terms, the trust cannot be a bare trust (in such cases the beneficial owner may qualify for relief under the category 1 provisions) and:

- the disposal must be of settlement business assets;
- a beneficiary must have an interest in possession (other than for a fixed term) in the settlement business assets;
- 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 (the amount used by the trustees reduces the amount available for the individual to use going forward).

We can advise on the definition of 'settlement business assets' and the detailed qualifying conditions.

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.

For relief to be available the beneficiary must be a qualifying individual in his own right. This means they must have been an officer or employee of the company throughout the qualifying period and have had a personal holding in the company which met the specific 5% conditions with respect to voting rights and percentage interest in the company's ordinary share capital. The percentage holding of the trustees is irrelevant.

Therefore, as a result of the narrow wording of the ER provisions for trustees, a detailed review should be undertaken to consider whether the assets or shares owned in a settlement will benefit from ER.

Note that if the conditions are not met there may be simple steps that can be taken to improve the situation. Where there is a discretionary trust a solution might be to create a life interest over settlement business assets.

Qualifying category 3 – disposal associated with a relevant material disposal

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 (or interests in) 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 company which is a member of the trading group).

The provisions are complicated and relief 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.

Relief is also restricted where, for the whole or part of the period of business use after 5 April 2008, the availability of the asset was dependent on the payment of rent. Where an individual owns a property used by his/her partnership or personal company, we can review whether the loss of ER that is caused by receiving rent is offset by other tax advantages.

How can we help?

ER is now worth a maximum of £900,000 to taxpayers, but the conditions are strict and merely holding business assets is not sufficient to qualify for relief. Specialist advice should be sought to ensure this valuable relief is maximised.

We can review your current assets to establish which currently qualify for ER. Where assets do not qualify we will advise on any actions which might improve the situation. Where assets do qualify we will warn against actions which, if taken, would lead to a total or partial loss of entitlement to ER.

ER will be a key relief for individuals that participate in family businesses and we would be happy to review the joint affairs of a couple or of a wider family unit.

At the start-up stage we can suggest a business structure that will be optimal both with respect to tax efficiency (the ability to claim ER being only one issue that must be considered) and from a commercial point of view. We can also provide specialist advice on the sale of a business to ensure that the deal consideration is structured as tax efficiently as possible.