

# Entrepreneurs' Relief



## OVERVIEW

Entrepreneurs' Relief is a very valuable capital gains tax relief available to individuals or trustees disposing of business assets such as shares and associated business assets in a trading company or the whole or part of a trading business.

The relief operates by applying a capital gains tax rate of 10% on gains up to a lifetime limit of £10 million. Without this relief, gains would be likely to be taxed at 20%.

## What is Entrepreneurs' Relief?

Entrepreneurs' Relief is a valuable capital gains tax ('CGT') relief which reduces the rate of CGT to 10% on eligible gains up to the lifetime limit of £10 million and it is available to individuals and trustees (dependent upon the nature of the trust). The reduced 10% rate compares with a standard CGT rate of 20%, resulting in a potential tax saving of £1m based on gains up to the lifetime limit.

## What assets qualify for Entrepreneurs' Relief?

Disposals of the following categories of assets qualify for Entrepreneurs' Relief, provided the relevant conditions are met:

- **Shares and securities in a trading company or the holding company of a trading group.**  
For these purposes "securities" includes loan notes received as part of a sale, reorganisation or reconstruction of a company. The relief applies to both listed and unlisted companies.
- **Transfer of the whole or part of a trading business as a going concern.**  
For these purposes a business is any trade, profession or vocation carried on either as a sole trade or in partnership on a commercial basis with a view to realising profits.
- **Assets in use on cessation of a trading business.**  
This relates to the disposal of assets used in a business which are personally-owned by the business owner (as sole-trader or in partnership), and which are disposed of when the business ceases.
- **Associated disposals of personal assets.**  
This applies to a disposal by a partner or shareholder of a personally-owned asset, which is used in the partnership or company at the same time as the disposal of the whole or part of their interest in the partnership or company and where that disposal qualifies for Entrepreneurs' Relief.

## What conditions must be met?

The conditions to be met depend on the category of asset being disposed of, although in each case the asset must have been held for at least 12 months prior to the date of disposal. The requirements for each category are set out below:

- **Shares and securities of a trading company or the holding company of a trading group**  
For a period of at least 12 months prior to the date of disposal, the company must be a trading company or the holding company of a trading group; the individual must hold at

least 5% of the company's ordinary share capital (by nominal value) and be able to exercise at least 5% of the voting rights; and the individual must also be an employee or office holder (broadly a director) in the company or a group company.

Note that conditions are relaxed for shares acquired through an Enterprise Management Incentive option, resulting in most shares acquired through this share scheme qualifying for the relief.

#### *Recent changes*

Prior to the 2015 changes it was possible to structure a business or company to enable certain individuals to obtain ER in circumstances where they would not otherwise have been entitled to the relief. Typically the structure made use of the joint venture provisions to "look through" a corporate entity, broadly that a proportion of the trade carried on by the underlying business was treated as being carried on by the corporate entity. This meant that by virtue of its shareholding in another company or its interest in a partnership the corporate entity would qualify as a trading company for ER purposes. As a result of the 2015 changes the corporate entity's interest in a partnership was disregarded, and the definition of trading company was amended so that the corporate entity was no longer treated as a trading company by virtue of its interest in another business. This meant its shares no longer qualified for ER unless it was a trading company in its own right.

However, these changes had an unintended impact on genuine commercial transactions. As a result, the March 2016 Budget introduced new provisions to allow shareholders to qualify for ER in genuine commercial transactions whilst still seeking to deny relief for "contrived" structures. Unfortunately the new provisions do not simply reverse the previous changes, but seek to prevent further perceived abuse. Inevitably this has led to greater complication in determining whether a particular structure qualifies for ER.

- **Transfer of the whole or part of a trading business as a going concern**

For a period of at least 12 months prior to the date of disposal, the business must be owned by the individual (either as a sole trader or in partnership); any assets held for investment will not qualify for the relief. Where a part of the business is disposed of, relief is generally only given where that part is distinct from the retained part, although the disposal of any interest in a partnership by a partner will qualify for relief.

#### *Recent changes*

The changes made in 2015 removed goodwill from the class of assets qualifying for ER where the person made a disposal of goodwill to a close company (broadly one controlled by five or fewer persons) which the individual was connected to (typically because they were a shareholder). This meant ER was no longer available on a disposal of goodwill as part of a typical incorporation of a sole trader or partnership business. The intention was to prevent individuals incorporating and obtaining the benefit of the growth in value of their business at a cost of only 10% tax. ER was still available if the individual was genuinely retiring from the business, but the changes created unwelcome tax charges for family businesses seeking to incorporate and pass on the business to the next generation. The changes announced in March 2016 amend the related party provisions so that they only apply where the person making the disposal, together with anyone connected to them, owns 5% or more of the shares or votes of the acquiring company.

For these purposes a connected person includes:

- o A company connected to the individual; and
- o Trustees connected to that individual.

Family members are now excluded from the definition of connected person for these purposes. This means that family businesses can be passed down to the next generation with the benefit of ER where the founder retains a small stake (less than 5% of the shares and votes) in the business going forward.

- **Assets in use on cessation of a trading business**

For a period of at least 12 months prior to date of cessation, the business must be owned by the individual (either as a sole trader or in partnership); and the disposal must take place within three years of the date of cessation of trade.

- **Associated disposals of personal assets**

The individual must make a material disposal of shares or an interest in a partnership, which qualifies for Entrepreneurs' Relief, prior to withdrawing from the business. The asset must be used for the purpose of the business for at least 12 months prior to the disposal of shares/partnership interest and not used for purposes unconnected with the business. Restrictions may apply where an amount equal to, or more than, market rent is paid for the use of the asset.

#### *Recent changes*

Where a business owner holds business assets outside the partnership or limited company that carries on their business (for example the business premises from which the business operates), it is possible to claim ER on a disposal of those assets, provided it meets certain conditions to be treated as an "associated disposal". The changes made in 2015 meant that to qualify for ER, an associated disposal would have to be accompanied by a "material disposal" of at least 5% of the business owner's interest in the business. In addition, where there was no "meaningful withdrawal" from the business and arrangements were in place to potentially allow the individual to retain the assets in the future (for example through someone connected to them such as a family member), ER was denied. These changes to the provisions meant that it was no longer possible to dispose of assets to family members, and hence restricted the options for succession planning for family businesses. To address this, changes have been made to allow ER to be claimed on an associated disposal of a privately-held business asset to a family member when the individual retires or reduces their participation in the business.

In addition, ER will not be denied where it is clear that the disposal is part of pre-planned family succession planning, which pre-dates the material disposal and the associated disposal. Families will therefore need to carefully document future plans to pass on the business in order to safeguard the availability of ER on future disposals of business interests and privately held assets used in the business.

### **What is the amount of the Relief?**

There is a lifetime limit of £10 million on gains qualifying for Entrepreneurs' Relief.

When do the "Recent Changes" changes apply? Finance Act 2015 introduced new rules to combat abuse of ER. As well as preventing abuse, the new rules impacted genuine commercial arrangements in a way not intended by Parliament.

#### *Recent Changes*

Were announced in the Finance Bill 2016 and are effective for disposals on or after 18 March 2015, when the Finance Act 2015 became effective.

### **How is the Relief claimed?**

Entrepreneurs' Relief is not automatic, and must be claimed in the tax return for the tax year in which the disposal is made. The time limit for making the claim is 12 months after 31 January following the end of the tax year in which the disposal is made.

### **How can Rawlinson & Hunter help?**

Unlike other "reliefs", Entrepreneurs' Relief is not just a deferral of tax but a reduction and a claim should be considered on all business disposals, even where deferral reliefs are available. We have a great deal of experience in advising entrepreneurs and business owners about their entitlement to Entrepreneurs' Relief, and the potential to claim the new relief available to long term investors known as "Investors Relief". We will also advise where claims could be beneficial as well as providing advice on business structures to ensure that the available relief is maximised for future disposal.

*If you are interested in further information in this regard, please contact the Rawlinson & Hunter partner who normally acts for you. Where you are not one of our regular clients, please contact Craig Davies or Andrew Shilling, who would be delighted to discuss this with you in more detail.*

#### **Craig Davies**

Direct Dial: (+44) 20 7842 2136

Email: [craig.davies@rawlinson-hunter.com](mailto:craig.davies@rawlinson-hunter.com)

#### **Andrew Shilling**

Direct Dial: (+44) 20 7842 2135

Email: [andrew.shilling@rawlinson-hunter.com](mailto:andrew.shilling@rawlinson-hunter.com)

## Rawlinson & Hunter

Eighth Floor  
6 New Street Square  
New Fetter Lane  
London EC4A 3AQ

And at

Q3, The Square  
Randalls Way  
Leatherhead  
Surrey KT22 7TW

T +44 (0)20 7842 2000

F +44 (0)20 7842 2080

[firstname.lastname@rawlinson-hunter.com](mailto:firstname.lastname@rawlinson-hunter.com)  
[www.rawlinson-hunter.com](http://www.rawlinson-hunter.com)

### Partners

Chris Bliss FCA  
Simon Jennings FCA  
Mark Harris FCA  
Frances Jennings ACA  
David Barker CTA  
Kulwam Nagra FCA  
Paul Baker ACA  
Sally Ousley CTA  
Andrew Shilling FCA  
Craig Davies FCA  
Graeme Privett CTA  
Chris Hawley ACA  
Phil Collington CTA  
Toby Crooks ACA  
Michael Foster CTA

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