

ENTREPRENEURS' RELIEF

When an individual disposes of an asset at a gain, capital gains tax may be due. Ordinarily, for gains falling above the higher rate threshold this will be charged at a rate of 20%. However, if entrepreneurs' relief (ER) is available, the rate will be reduced to 10%.

ER is applicable where individuals or trustees make "qualifying business disposals", and can be claimed in respect of gains of up to £10 million over the course of a lifetime. At today's capital gains tax rates, it can result in a potential tax saving of up to £1 million per person, so it is a valuable relief that should be secured wherever possible.

Qualifying business disposals

Set out below are the key types of assets that can give rise to qualifying business disposals, along with some of the specific conditions that must be met if the disposal is to qualify.

Whole or part of a business

The disposal of the whole, or a separately identifiable part, of an unincorporated business (which includes a business carried on in partnership) should be eligible for ER where the business was owned by the individual throughout the 24 months ending with the disposal (12 months for disposals broadly prior to 6 April 2019). The business must have been a trade, profession, or vocation that was carried on with a view to profit.

An important point to note is that the sale of a business asset or assets may not amount to the sale of all or part of a business. ER is not available where an individual transfers an unincorporated business to a company that the individual controls.

Assets in use for the purpose of a business

The disposal of assets in use for the purpose of a business at the time the business ceases to trade should be eligible for ER where the business was owned by the individual throughout the 24 months ending with the cessation and where the assets are sold within three years. For disposals prior to 6 April 2019, the relevant period was 12 months. The period was also 12 months for disposals on or after 6 April 2019 where the business ceased prior to 29 October 2018.

Shares in a company

There are two main circumstances in which the disposal of shares can qualify.

Firstly, the disposal of shares should qualify where the company was the individual's "personal trading company" and the individual was an officer or employee of the company or (if the company is in a group) of at least one group member company. For disposals prior to 6 April 2019, the relevant period was 12 months. The period was also 12 months for disposals on or after 6 April 2019 where the business ceased prior to 29 October 2018.

A company will have been an individual's personal trading company in the qualifying period ending with the disposal if:

- The company was a trading company or the holding company of a trading group; and
- The individual owned at least 5% of the company's ordinary share capital, and by virtue of that holding:
 - can exercise at least 5% of the voting rights in the company; and
 - is beneficially entitled to at least 5% of the dividends and assets available to the 'equity holders' on a winding-up of the business, and/or sale proceeds due to the ordinary shareholders on a notional disposal.

For disposals prior to 29 October 2018, individuals would meet the 5% test where they owned at least 5% of the ordinary share capital, by virtue of which they owned at least 5% of the voting power.

Entitlement to ER can be preserved where an individual's shareholding is diluted below 5% on or after 6 April 2019. The dilution must be as a result of the issue of shares in exchange for cash commercial reasons by the company during the qualifying period (for instance on a new share subscription by incoming investors).

If the election is made, the gain crystallises at the point of dilution. In order to ensure that the gain is not chargeable at that point, a second election must be made to defer the crystallised gain until a subsequent disposal of the shares.

Secondly, the disposal of shares in a company can also qualify where it is made within three years of the company ceasing to trade, and where the relevant conditions were met throughout the qualifying period ending with the cessation of trade. For disposals on or after 6 April 2019, the qualifying period is 24 months, unless the business ceased prior to 29 October 2018, in which case the qualifying period is 12 months.

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Entrepreneurs' relief on EMI shares

The disposal of shares should also qualify where, for the 24 months ending with the disposal (12 months for disposals prior to 6 April 2019):

- The company was a trading company or holding company of a trading group (i.e. not necessarily a personal trading company); and
- The individual was an officer or employee of the company or (if the company is in a group) of at least one group member company; and
- The individual acquired the shares by exercising EMI options which were granted at least 24 months (12 months for disposals prior to 6 April 2019) prior to the disposal.

Trust business assets

- While this flyer primarily considers ER for individuals, it is worth noting that disposals of trust business assets may also qualify for entrepreneurs' relief in limited circumstances.

How can Moore Kingston Smith assist?

ER can be very valuable and, to stand the best chance of qualifying, it is advisable to consider the rules well in advance of a potential disposal. There is a range of assets which can, when sold, qualify for ER, although in each case there are complex provisions and a number of pitfalls to avoid.

We would be pleased to discuss your particular circumstances and provide advice in relation to your eligibility for ER.

Contact us on 020 7566 4000.