Chartered Institute of Taxation
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Entrepreneurs' Relief

A summary for CIOT Members of this important CGT relief

Part One: Transactions where entrepreneurs' relief may be applicable
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PART ONE

Entrepreneurs' Relief: Transactions where entrepreneurs' relief may be applicable

Chapter 1: Setting the scene

Introduction

Entrepreneurs' Relief is a capital gains tax ('CGT') provision designed to reduce the burden of taxation otherwise payable on capital gains realised by individuals (and some trustees) in respect of certain business assets disposed of in circumstances falling within the conditions laid down. The relief must be claimed within the time limit stipulated. Entrepreneurs' Relief is not available to reduce the corporation tax payable on gains made by companies.

Broadly speaking, entrepreneurs' relief applies primarily to gains realised by individuals on the disposal of certain qualifying business assets where it can be shown that the assets in question have been realised in the course of disposing of all or part of a business (or where the asset is disposed shortly after the cessation of the business in which it was used). In addition, entrepreneurs' relief can be applicable to gains realised on the disposal of shareholdings in certain trading companies (and shares in certain holding companies) where the relevant conditions are satisfied.

Although entrepreneurs' relief is conceptually quite simple, the structure of the provisions gives rise to many anomalies. Members may well be surprised to find that some gains which might thought not to attract relief do attract relief, while other gains – arising in situations where logic suggests entrepreneurs' relief should operate, do not attract relief for technical reasons.

Trustees do not have an entitlement to entrepreneurs' relief in respect of trust gains. However, a special provision exists under which certain beneficiaries may effectively surrender their lifetime entrepreneurs' relief allowance (see below) to the trustees of a settlement in which they have an interest in possession. This surrender of relief is possible in two situations. Chapter 5 summarises the position as regards trust gains.

Lifetime Allowance (Overriding Entrepreneurs' relief limit)

There is a limit on the amount of gains that can benefit from entrepreneurs' relief during a taxpayer's lifetime. For the period 6 April 2008 to 5 April 2010 the maximum gains that could benefit from Entrepreneurs' Relief was £1 million. For gains realised on disposals during the period 6 April 2010 to 22 June 2010, the lifetime limit was increased to £2 million.

Finance (No 2) Act 2010 remodelled both the extent and nature of the relief in respect of disposals made after 22 June 2010. For disposal made on or after 23 June 2010, gains of up to £5 million during an individual's lifetime can be benefit from the remodelled relief. The nature and extent of the relief – including the major impact of the Finance (No 2) Act 2010 - is discussed in Chapter 6. Suffice to say in this introduction:

- for the period from 6 April 2008 to 22 June 2010 inclusive, entrepreneurs' relief was given effect by reducing the otherwise chargeable capital gain by 4/9$^{\text{ths}}$ (so as to give an effective rate of 10% on gains attracting relief), whereas

- gains attracting relief in respect of disposals on or after 23 June 2010 are not so reduced. Instead, post 22 June 2010 eligible gains are to be taxed a special lower rate of capital gains tax, i.e. the 10% CGT rate (see revised Section 169N(3) TCGA 1992).

For ease of reference, the main focus of this summary is on the CGT provisions as they apply to disposals taking place on or after 23 June 2010 but Chapter 6 describes the position prior thereto. Here it is important to note that there was a need to amend certain aspects of the initial provisions in order to accommodate the introduction of the 10% rate referred to above and, therefore, the F(No2)A 2010 changes amounted to more than a cosmetic change to the procedure by which qualifying gains were charged to tax. An anomaly created by the F(No2)A 2010 is that, while the provisions still refer to the measures described herein as being a 'relief', the reality is that, as stated above, a special rate of CGT has been created which is to be applied where appropriate to gains where certain conditions are met and a claim is made.

The summary set out in the following pages is designed to set the scene for Members as regards straightforward situations; it is not intended to be an exhaustive examination of the entrepreneurs' relief. Of necessity, it is assumed by the writer that all members reading this summary possess at least a basic understanding of the TCGA 1992 as revised and are, accordingly, familiar with the capital gains tax provisions as they apply to individuals and trustees.

In the final analysis, readers must appreciate that the wording of the relevant statute and the interpretation thereof as guided by case law (including the established retirement relief tax cases), will determine whether or not entrepreneurs' relief is due (and, if so, the quantum thereof) in any given situation. This summary should not be seen as a substitute for the statutory provisions found in Section 169H to 169S and members are urged to study the provisions and relevant case law before advising on the facts of any particular case.

Which Gains Can Potentially Attract Entrepreneurs' relief?

Before examining the entrepreneurs' relief provisions in more detail, it may be helpful to examine the following list of disposals where entrepreneurs' relief is potentially relevant in relation to an individual.

Entrepreneurs' Relief is due only in respect of a capital gain arising on what is referred to as a ***'material disposal of business assets'*** (Section 169I). In relation to an individual, such disposals can, broadly speaking, be summarised as set out below (as regards trust gains see Chapter 5). In each instance, reference to a business carried on is a reference to a business carried on for not less than one year:

1. a disposal of the whole of a business carried on by a sole trader,
2. a disposal of part of a business carried on by a sole trader,
3. a disposal of the whole of a business carried on by a trading partnership
4. a disposal of part of a business carried on by a trading partnership
5. a disposal by a partner of the whole of his interest in a trading partnership,
6. a disposal by a partner of part of his interest in a trading partnership,
7. a disposal of one or more assets previously used in a business carried on by a sole trader where the asset disposal takes place not more than 3 years after the cessation,
8. a disposal by a former partner of one or more assets previously used in a business carried on by a partnership of which he was a member where the asset disposal takes place not more than 3 years after the cessation of the partnership business in question,
9. a disposal of shares in (or securities of) a company which, throughout the relevant one-year period, was either a trading company or a holding company of a trading group, made by an individual who throughout that same one-year period can show that:

- he was either an officer or employee of the company (or of one or more companies in the group), and
- can demonstrate that the company is his personal company (as defined),

10. a disposal by an individual (usually referred to as an 'associated disposal') of one or more assets owned by him which is made in association with a disposal falling within (3), (5) & (9) above, as part of the taxpayer's withdrawal from the business in question. (Note: the relief available in respect of such associated disposals may well be subject to restrictions - see Chapter 4.)

Disposals of business assets in circumstances other than those described above are unlikely to attract entrepreneurs' relief.

The following example demonstrates one such situation.

EXAMPLE 1

Arthur has been in business as a sole trader for many years manufacturing widget covers. In January 2011, Arthur disposed of the freehold factory premises and moved his established business into new rented accommodation. Arthur's motive was to release some of the capital otherwise tied up in his business and to make it easier to find a buyer for the business in 5 years' time at which point Arthur hopes to retire. Arthur's view was that trying to sell the business operating from its existing premises on his subsequent retirement would be far more difficult from a commercial standpoint than selling the same business operating from modern leasehold premises.

Arthur crystallises a £1 million capital gain on the disposal of the old business premises. A friend from the Ramblers Association has told him that he will only pay tax at 10%.

Arthur will not be in a position to claim entrepreneurs' relief and so the 2010/11 capital gains tax rate to be applied to the £1 million gain will be 28%[1] - not 10%. Arthur's disposal does not fall within the disposals to be regarded as ***'material disposal of business assets'*** summarised above (and discussed further in Chapter 2). In particular, Arthur has not disposed of a business or part of a business. His disposal is merely of an asset used in the business carried on by him. Arthur's business has simply been relocated to new premises and the asset disposal does not fall within Section 169I TCGA 1992.

Chapter 2 also outlines possible steps Arthur (in the above example) could have considered taking prior to the date of disposal in order to create a situation where entrepreneurs' relief could be properly claimed.

The mere fact that a disposal can be properly considered a ***'material disposal of business assets'*** does not by itself give rise to entitlement to relief as other conditions must be met and the exact conditions applicable depend upon the nature of the disposal in question. The immediately following chapter examines the position relating to unincorporated business and Chapter 4 examines the relief in relation to incorporated business. Chapter 5 addresses the relief in relation to gains realised by trustees.

Readers are reminded that no entrepreneurs' relief can be allowed by HMRC unless a proper and timely claim is made. This aspect is discussed in Chapters 5 and 6.

The maximum relief in tax terms

Given there is currently a £5 million cap on the maximum gains arising to an individual which can benefit from the 10% rate, it will be appreciated that the maximum savings in tax terms arising to any one individual is £900,000, i.e. 18% of £5 million.

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[1] In this and all other examples in this guide it is assumed for simplicity that the taxpayer is liable to income tax at the higher rate, and so falls into the 28% CGT rate in full.

Chapter 2: Unincorporated businesses

This chapter explores the aspects of entrepreneurs' relief contained in Sections 169H to 169S TCGA 1992 in relation to unincorporated businesses carried on by:

- sole traders and
- individuals in partnership.

Meaning of "Business"

The focus of the legislation covering entrepreneurs' relief is on businesses. Section 169S(1) states:

For the purposes of this Chapter, "a business" means anything which:-

(a) is a trade, profession or vocation, and

(b) is conducted on a commercial basis and with a view to the realisation of profits.

For this purpose, 'trade' includes any venture in the nature of trade (see Section 169S(5) and Section 989 ITA 2007). Section 241(3)(3A) has effect so as to include activities falling within the income tax furnished holiday accommodation provisions (Section 323 ITTOIA 2005).

There is no geographical restriction operating under the entrepreneurs' relief provisions. It matters not where the business is carried on – it matters only that the taxpayer is liable to UK capital gains tax on the gains arising in relation thereto.

In the context of disposals by individuals relating to unincorporated businesses, Section 169H requires that there is a ***material disposal of business assets*** falling within Section 169I comprising ***relevant business assets*** (defined by Section 169L- see below) if relief is to arise. There is a material disposal of business assets in this context where:

1) an individual makes a disposal of business assets being either:

   - the disposal of the whole of an unincorporated business, or
   - the disposal of part of an unincorporated business, or

AND the business has been owned for one year at the date of the disposal,

OR,

2) a business has already ceased to be carried on by the taxpayer and:

   - the disposal is a later disposal of an asset which was in use for the purposes of the business at the date of its disposal,

   AND

   - the asset disposal takes place not more than three years following the date on which the taxpayer's business ceased to be carried on by him.

As regards assets disposed of not later than three years after the taxpayer ceased to carry on an unincorporated business, it is important to note that there is no restriction as to the use of the asset subsequent to the cessation date.

EXAMPLE 2

Anthony has been in business as a sole trader for many years manufacturing widget display boxes. On 10 May 2011, he accepts an offer and sells the entire business undertaking realising a £2 million capital gain. The purchaser does not acquire the freehold trading premises and instead enters into a licence to occupy for 12 months. A full market rent is paid. The premises become vacant in April 2012 and Anthony then lets the property for a further 18 months to XYZ Co Ltd at a market rent.

Anthony sells the property on 30 April 2014 realising a capital gain of £1 million.

Anthony, can claim that the 10% rate of CGT should be applied to the 2014/15 £1million capital gain. The date disposal thereof falls not later than the third anniversary of the cessation of the business on 10 May 2011.

EXAMPLE 3

If we now assume the same facts are as in the above example except that Anthony disposes of the property on 26 May 2014, the lower rate of capital gains tax cannot be applied to the 2014/15 capital gain, this gain will be charged at 28%.

"Relevant Business Assets" (Section 169L)

Entrepreneurs' relief is only given in respect of gains made by an individual on the disposal of ***relevant business assets.*** In the case of an unincorporated business, this means assets (including goodwill) which are used for the purposes of a business carried on (i.e. carried on either by the sole trader or a partnership of which the individual is a member) other than excluded assets. Section 169L(4) defines excluded assets as being:

(a) shares and securities, and

(b) assets, other than shares or securities, which are held as investments.

One example of a possible example of a sale comprising an 'excluded asset' is where a farmer disposes of his farming business and comprised in the sale is holding of shares in company which operates the regional trading association.

It should be noted that there is no provisions to restrict relief where part only of an asset comprised in the disposal of a business has been used in the business.

What is meant by 'part of a business'?

A major distinction between the now abolished CGT taper relief and entrepreneurs' relief is that a gain made on a simple asset sale could qualify for taper relief (and thus attract an effective rate of 10%) whereas, under entrepreneurs' relief, if an asset sale takes place while the business is continuing, a claim to relief may well fail.

As already stated above, for entrepreneurs' relief to apply in relation to unincorporated businesses, there must be a disposal of either all or part of the business or the business must have already ceased and the assets in use at the cessation date are disposed of after the cessation date but before the third anniversary thereof. While it is easy to establish whether or not a business has been disposed of, or has simply ceased, difficulties can arise in practice in determining whether an asset disposal arises in connection with the disposal of 'part of a business'.

The good news is that the questions to be addressed here have already been explored in relation to very similar provisions contained in the former CGT retirement relief, in particular in the case of McGregor (HMIT) v Adcock (1977 STC 206). The bad news is that, despite the case law, the matter is often one of considerable doubt and Members should exercise considerable caution when advising in this area. Mr Adcock had sought to demonstrate that the sale of 4.8 acres of farmland, out of a total of 35 acres farmed by him, amounted to a disposal of part of the business being carried on by him. (Not long before the sale, he had obtained planning permission to develop the 4.8 acres and so the sale crystallised a substantial gain, which he was anxious to reduce by retirement relief.) In the report of the judgement, Fox J. is recorded as saying:

> 'In my view, there is thus a clear distinction between the business and the individual assets used in the business. Prima facia, therefore, it seems to me wrong to assert that the mere sale of farmland is a disposal of part of the farm business. The true position, I think, is that the sale is merely a factor which the court has to consider in deciding whether there has been such a disposal. There are cases in which it might be the

determining factor. Thus, if a man is farming 200 acres and sells off 190 of those acres, it may very well be that the nature and extent of the man's activities after the sale would be so wholly different from what they were before the sale that the inevitable conclusion would be that there had been a disposal of part or even the whole of the farming business.'

Subsequent to the McGregor v Adcock case referred to above there were a number of cases exploring essentially the 'part of a business' test. Space neither permits a full analysis of Mr Adcock's situation or the later cases but members should refer to Atkinson v Dancer (1988 STC 758), Mannion v Johnston (1988 STC 758), Pepper v Daffurn (1993 STC 446) and Jarmin v Rawlings (1994 STC 1005). The cases of Wase v Bourke (1996 STC 18), Barret v Powell (1998 STC 283) and Purves v Harrison (2001 STC 267) also merit attention.

Planning opportunities?

In areas where it is clear that the intended disposal under consideration is of a freestanding asset, not involved in the disposal of a business or part thereof, Members who are advising in advance of a transaction need to be alert to the opportunity to bring about a timely cessation of the unincorporated business carried on by the taxpayer. See the following simple example.

EXAMPLE 4

Angela is a sole trader and she is hoping to sell some land to a property developer. The land is currently in use in her business as customer car parking. She has been trading for many years and has no intention of disposing of any part of her business. Without taking some action, she will not be able to benefit from entrepreneurs' relief. However, a Member instructed to advise should consider drawing the following to her attention.

Angela is likely to be in a position to enjoy entrepreneurs' relief on the land disposal if she first engineers a cessation of her business. This will be so even if this is a cessation from a taxation standpoint only. Accordingly, Angela may wish to consider transferring the on-going business activity to a company controlled by her with a view to doing so prior to entering into the contract for disposal of the land to a developer.

By transferring the business to the company, Angela will have ceased to carry it on. If the disposal of the land falls after the cessation date of the unincorporated business, the land disposal will give rise to a gain falling within the post cessation disposal rules (providing the land is sold not more than three years after the cessation date) found in Section 169I(4).

Clearly, any advice advanced along the lines suggested above should not be carried out in isolation to Angela's overall tax position, including income tax (e.g. PAYE and benefit in kind issues) and VAT matters and, of course, there will be other capital gains tax issues. Another option open to Angela is shown in the following example.

EXAMPLE 5

The facts are as in Example 4 except that Angela is happily married. Here, she considers transferring the business to her husband Tom prior to the land sale. By doing this she will have ceased to run the business prior to the land sale – and her husband will have commenced to run what to him will be a new business. Of course, Tom will want to employ Angela as business manager to run the business for him and will wish to pay her the market rate for the job. Therefore, the first obvious downside will be the on-going increase in national insurance contributions.

All such downsides have to be evaluated and, while Section 58 TCGA 1992 will operate to prevent any CGT arising on the disposal of the business goodwill to Tom, when all factors are taken into account Angela may prefer to rely on incorporation of the business as the solution rather than involving her husband.

Calculating the Relief Due

Chapter 6 summarises the issues relating to the quantum of the relief due generally but one special feature of the relief relating to unincorporated businesses, which can be easily overlooked, relates to the position arising where the business disposal comprises more than one asset and a loss arises on at least one of the assets disposed of.

Section 169N requires that the losses on any of the assets comprised in the business disposal must be aggregated and deducted from the aggregate of the gains realised on the business assets. Effectively, entrepreneurs' relief applies to the net amount of gains realised on the business assets after deducting any losses on loss-making assets from the aggregate gains arising.

> **EXAMPLE 6**
>
> Stephen sells his stationery business to a property developer, making a £500,000 capital gain on the sale of the premises but a £20,000 loss on the disposal of the goodwill due to the business terminating.
>
> Accordingly, the gain that can benefit from entrepreneurs' relief is £480,000.

Obviously, if the losses on the business assets exceed the gains thereon, entrepreneurs' relief cannot apply. It is not possible to set the loss against gains arising on non-business assets.

Partnerships (Including LLPs)

A major simplification is afforded to the entrepreneurs' relief implications as regards partnerships. S169I TCGA 1992 states that for 'the purposes of this section:-

> (a) an individual who disposes of (or of interests in) assets used for the purposes of a business carried on by the individual on entering into a partnership which is to carry on the business is to be treated as disposing of a part of the business,
>
> (b) the disposal by an individual of the whole or part of the individual's interest in the assets of a partnership is to be treated as a disposal by the individual of the whole or part of the business carried on by the partnership, and
>
> (c) at any time when a business is carried on by a partnership, the business is to be treated as owned by each individual who is at that time a member of the partnership.

Put simply, the structure of the legislation coupled with the above provision seems to resolve most, if not all, of the uncertainties surrounding partnership transactions. Transactions involving the disposal by a partnership of one or more interests in a business, as well as transactions between the partners as regards increasing/decreasing a partner's share in the partnership business, will be treated as disposals/part disposals of a business for the purposes of entrepreneurs' relief. Although the McGregor v Adcock decision discussed earlier in this chapter will still apply as regards business disposals made by the partnership, it will not apply in cases involving a simple reduction in a partner's share of the business.

For example, a partner who possesses an eight per cent interest in a partnership may be able to claim entrepreneurs' relief if a capital gain arises on his disposal of his entire interest in the partnership or a fractional share thereof, e.g. reducing his stake by one-quarter to six per cent.

Of course, Statement of Practice D12, issued by HMRC, lays down generally the treatment of transaction relating to partnerships and due consideration must be given thereto when advising in this area.

> **EXAMPLE 7**
>
> On 1 April 2011, Richard retires from a professional partnership after 20 years as an equity partner. Immediately before his retirement, he possessed 27% of the business. Under the retirement deed he transfers 7% to William, the senior partner, and while two new partners each acquire a 10% share from Richard.

Say that, under SP D12 referred to above, it is calculated that Richard's aggregate capital gains on his retirement amounts to £600,000. The entire gain can benefit from the reduced rate of CGT under the entrepreneurs' relief provisions.

EXAMPLE 8

On 1 May 2011, Robert reduces his 10% interest in a partnership, of which he has been a member for 18 years, to 9% and it is calculated that a capital gain arises under SP D12 of £ 80,000. Entrepreneurs' relief can apply to Robert's £80,000 gain.

Note: Special rules operate as regards individuals ceasing to be partners who, in association therewith, make one or more disposals of assets owned outside the partnership (but used within the partnership's business). The 'associated disposal' provisions are discussed in Chapter 4.

Husband and Wife Partnerships

It should not be overlooked that partnerships between a husband and wife (or between two civil partners) are treated like any other partnership. With this in mind readers should not overlook that in certain situations the parties may be able to take advantage of Section 58 TCGA. For example where Fred possess a 25% share in the partnership with his wife Mary owning the remaining 75%, it may be beneficial to equalise their respective stakes in the business if Mary's gain on the disposal of the business in question is thought to exceed her £5million lifetime allowance.

Similarly, if the business is to be sold but one spouse has been a member of the partnership for less than one year, it may be beneficial for the ownership of the business to revert to that of a sole trader. That would ensure the only individual disposing of the business to a third party has been running the business for at least one year.

Chapter 3: Office holders (& employees) of incorporated businesses

This chapter explores the aspects of entrepreneurs' relief contained in Section 169H to Section 169S TCGA in relation to capital gains realised by officers (& employees) of trading companies (and of certain group companies) in relation to capital gains realised on investments in shares or securities in such companies. For ease of reference, this summary will refer only to shares (except where otherwise indicated) rather than to shares and securities.

To benefit from entrepreneurs' relief in respect of a gain arising on a disposal of shares, individuals must show that they have made a ***material disposal of business assets.*** It is necessary to demonstrate that both the individual claimant and the company, to which the shares relate, satisfy a number of conditions. These conditions have to be met throughout the relevant period. (Section 169I(6))

The 'Relevant One-year Period'

The 'relevant one-year period' is not a phrase found in the statute. Rather, it is used by the writer as a term of convenience to refer to one of three possible one-year periods. In each case, the availability of relief will require the 'relevant one-year period' to have been properly identified, as follows:

(a) In the case of shares disposed of in a company that is a trading company or the holding company of a trading group as at the time of disposal, the relevant one-year period is the period of one year ending with the disposal date of the shares in question.

(b) In the case of shares disposed of in a company where the company has ceased to be a trading company (without continuing to be, or becoming, a member of a trading group), the relevant one-year period is the period of one year ending on the date the trading company status ceased. However, it cannot be a period that ends more than three years before the disposal date of such shares.

(c) In the case of shares disposed of in a company which has ceased to be a member of a trading group (without continuing to be, or becoming, a trading company), the relevant one-year period is the period of one year ending on the date the company in question ceased to be a member of a trading group. However, it cannot be a period that ends more than three years before the disposal date of such shares.

Properly identifying the relevant period can be particularly significant when planning the winding up of a company previously involved in trading activities.

Share disposals: Requirements as regards the individual

Firstly, the individual making the disposal in question must be able demonstrate that, throughout the relevant one-year period referred to above, he has been either:-

(a) an officer or an employee of the company in question, or
(b) in the case of shares disposed of in the holding company of a trading group (as defined in Section165A), an officer or employee of one or more companies that are members of that group.

Secondly, throughout relevant one-year period referred to above, the individual must be able to demonstrate that the company has been his 'personal company' as defined by Section169S(3). This states that 'personal company', in relation to an individual, means a company:-

(a) at least 5% of the ordinary share capital of which is held by the individual, ***and***

(b) at least 5% of the voting rights in which are exercisable by the individual by virtue of that holding.

Therefore, in addition to owning at least 5% of the ordinary share capital the individual must be able to exercise at least 5% of the voting rights therein. 'Ordinary share capital' means all the company's issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits

In the author's view, it is only the shares beneficially owned by an individual that can be taken into account in satisfying the personal company test.

As regards joint shareholdings, for the purposes of the above test the shares (and voting rights) are treated as being owned in accordance with each joint owner's underlying beneficial ownership thereof (Section 169S(4)).

Thirdly, the claimant must be able to demonstrate that, throughout the relevant one-year period discussed above, the company to which the shares relate has met the requirements of the legislation detailed below.

Share disposals: Requirements as regards the company

It is only possible for capital gains arising on the disposal of shares in a company to attract entrepreneurs' relief where it can be shown that throughout the relevant one-year period (see above) the company in question was either:

- a ***Trading Company*** as defined, or
- it was the ***Holding Company of a Trading Group***.

Much has been written and said about the meaning of the above expressions and space does not permit a detailed analysis in this summary. In accordance with Section 169S (5), it is necessary to turn to Section 165A TCGA (re holdover relief). For a full definition, reference should be made to Section 165A. However, the following call for comment here.

'Trading company'

Section 165A makes clear that 'trading company' means a company carrying on trading activities whose activities do not include to a substantial extent activities other than trading activities. The phrase 'substantial extent' is not defined but HMRC is understood to consider substantial to mean more than 20%. For further guidance as to HMRC's thinking as to the meaning of 'substantial', see HMRC's CG Manual, paragraph 60490.

For the above purposes, 'trading activities' means activities carried on by the company:-

(a) in the course of, or for the purposes of, a trade being carried on by it,

(b) for the purposes of a trade that it is preparing to carry on,

(c) with a view to its acquiring or starting to carry on a trade, or

(d) with a view to its acquiring a significant interest in the share capital of another company that—

(i) is a trading company or the holding company of a trading group, and

(ii) if the acquiring company is a member of a group of companies, is not a member of that group.

However, activities will not qualify as trading activities under subsection (c) or (d) above unless the acquisition is made, or the company in question starts to carry on the trade, as soon as is reasonably practicable in the circumstances. Reference in (d) above to the acquisition of a significant interest in the share capital of another company is to an acquisition of ordinary share capital in the other company:-

(a) such as would make that company a 51% subsidiary of the acquiring company, or

(b) such as would give the acquiring company a qualifying shareholding in a joint venture company without making the two companies members of the same group of companies (see below re Joint Ventures).

'Holding company of a trading group'

'Holding company' means a company that has one or more 51% subsidiaries and 'trading group' means a group of companies—

(a) one or more of whose members carry on trading activities, and

(b) the activities of whose members, taken together, do not include to a substantial extent activities other than trading activities.

For this purpose, the activities of the members of a group of companies are to be treated as one business (with the result that activities are disregarded to the extent that they are intra-group activities).

For the purposes of the trading group definition, 'trading activities' means activities carried on by a member of the group:

(a) in the course of, or for the purposes of, a trade being carried on by any member of the group,

(b) for the purposes of a trade that any member of the group is preparing to carry on,

(c) with a view to any member of the group acquiring or starting to carry on a trade, or

(d) with a view to any member of the group acquiring a significant interest in the share capital of another company that—

(i) is a trading company or the holding company of a trading group, and

(ii) is not a member of the same group of companies as the acquiring company.

Activities do not qualify as trading activities under subsection (c) or (d) above unless the acquisition is actually made, or the group member in question actually starts to carry on the trade, as soon as is reasonably practicable in the circumstances. Reference in (d) above to the acquisition of a significant interest in the share capital of another company is to an acquisition of ordinary share capital in the other company:-

(a) such as would make that company a member of the same group of companies as the acquiring company, or

(b) such as would give the acquiring company a qualifying shareholding in a joint venture company (without making the joint venture company a member of the same group of companies as the acquiring company). See below regarding 'joint venture' companies.

Calculating the Relief Due

Chapter 6 summarises the issues relating to the quantum of the relief due generally but one special feature of the relief relating to shares and securities of companies worth emphasising here is that, once having satisfied the test for the relevant one-year period, there is no requirement to have owned all the shares or securities throughout the period in question.

EXAMPLE 9

Fred sells all his shares in FredExCo Ltd on 1 July 2011 having owned at least 5% of the ordinary shares (and voting rights) for several years. He has been a director of the company for several years.

On 1 June 2011, Fred acquired his wife's shareholding, being 39% of the issued share capital. Under Section 58 TCGA 1992, Fred was deemed to acquire his wife's former holding for such a consideration as would create neither a gain nor a loss in respect of his wife. His wife's shares had grown substantially in value during her ownership but the effect of Section 58 is that this growth in value falls to be assessed on Fred. Section 58 thereby substantially increases Fred's assessable gain on the 1 July 2011 disposal.

Providing Fred can show that FredExCo Ltd was a trading company throughout the one-year relevant period ending on 1 July 2011, the full gain assessable (up to £5 million) will attract entrepreneurs' relief- despite the fact that part of the shareholding disposed of on 1 July 2011 was owned for less than one year. Clearly, the acquisition of shares by Fred from his wife must be genuine and not him merely acting as her nominee or bare trustee. This will be a question of fact, which may be examined by HMRC if the 2011/12 tax return is enquired into.

Joint ventures

As alluded to above, special provisions are included with the definitions of 'trading company' and 'holding company of a trading group' to accommodate the commercial need for the establishment of joint venture companies.

In short, in determining whether a company is a trading company

- where the potential trading company has a qualifying shareholding in a joint venture company the shares in that company are to be ignored (i.e. not treated as investment assets), and
- the potential trading company is to be treated as carrying on a proportion of the activities of the joint venture company (or where the joint venture company is the holding company of a trading group, of the activities of that group). The proportion to be included follows the percentage of the ordinary share capital held in the joint venture company.

Similarly, determining whether a company is a holding company of a trading group, where that holding company (or one of its subsidiaries) has a qualifying shareholding in a joint venture company:-

- the shares in that joint venture company are to be ignored (i.e. not treated as investment assets), and

- the potential trading group is to be treated as carrying on a proportion of the activities of the joint venture company (or where the joint venture company is itself the holding company of a trading group, of the activities of that group). The proportion to be included follows the percentage of the ordinary share capital held in the joint venture company.

A detailed analysis of the provisions catering for joint ventures is outside scope of this summary and Members are referred to Section 165A for detailed provisions relating thereto.

Note: Special rules operate as regards individuals disposing of shares in their personal companies in association therewith make one or more disposals of assets owned personally by them but which have been provided for use within the business carried on by the company in question. The 'associated disposal' provisions are discussed in Chapter 4.

Liquidations

Capital distributions made on the liquidation (or striking off) of a company giving rise to capital gain attracts entrepreneurs' relief in a like manner to any other disposal for CGT purposes.

Chapter 4: 'Associated disposals' by partners of company officers/employees

This chapter explores the aspects of entrepreneurs' relief that can often cause confusion in the minds of taxpayers, the so-called 'associated disposals. The relevant provisions are to be found in Sections 169K and 169P. It is important to note that the provisions relate only to:

- partners making disposals of one or more assets owned personally by them (i.e. owned outside the partnership) at the time they are disposing of their interest in the partnership.
- officers (or employees) making disposals of one or more assets owned personally by them and made available to their personal company at a time when they are also disposing of their interest in the shares of the company.

Under no circumstances can the associated disposal provisions have any application to the disposal by a sole trader (or to Trustees' disposals - see Chapter 6).

Broadly speaking, Section 169K establishes which asset disposals may qualify as associated disposals for the purposes of entrepreneurs' relief while Section 169 seeks to restrict the quantum of the relief in certain circumstances.

Qualifying disposals: Section 169K

Under Section 169K, an individual makes a disposal (Disposal 1) associated with a relevant material disposal (Disposal 2) if Conditions A, B and C below are met, viz.

Condition A

The individual must make a material disposal of business assets (see Chapter 2) consisting of either:-

(a) the disposal of the whole or part of the individual's interest in the assets of a partnership, or

(b) the disposal of (or of interests in) shares in or securities of a company.

Condition B

The individual must make the above disposal (i.e. Disposal 1) as part of his withdrawal from participation in the business carried on by the partnership or by the company or (if the company is a member of a trading group, carried on a company which is a member of the trading group in question).

Condition C

Throughout the one-year period ending with the earlier of—

(a) the date of the material disposal of business assets, and

(b) the cessation of the business of the partnership or company,

the asset disposed of under Disposal 1 was in use for the purposes of the business carried on by the partnership or the company in question.

Before exploring the extent to which relief is available, it is necessary to summarise the above. In short, entrepreneurs' relief may also be due where there is a disposal of an asset owned by an individual but used for the purposes of a business carried on by either –

- a partnership in which the individual is a partner or

- a trading company that is the individual's personal company (see also special rules for use in the business of a group company).

Such a ‘disposal associated with a relevant material disposal’ will be considered as a so-called associated disposal when all three of the above conditions are met. It is perhaps worth noting that there is no requirement for a gain to arise on this business interest disposal and neither must there be a claim to entrepreneurs' relief to be made in respect thereof.

It will be noted that under Condition B the associated disposal is to be made as part of the process of withdrawal of the individual from participation in the business of the partnership or the trading company. Precisely what this involves in any one case can give rise to uncertainty and will depend upon the facts of each case. HMRC’s CG Manual, paragraph 63995, contains some useful input.

Restrictions in the amount of the relief: Section 169P

Section 169P restricts the amount of gain that can benefit from entrepreneurs’ relief to such a sum as is considered just and reasonable – leaving the balance of the gain not attracting relief to be charged at the full rate of CGT. The restrictions, to be found in subsection 3, apply in four different situations. The four situations that can result in restriction are as follows:-

1. Where the associated disposal relates to an asset that has been used in the business referred to above (i.e. the business of the partnership or personal company) for part only of the individual’s ownership. Here, the just and reasonable restriction to the relief will be made by reference to the period of business use when compared to the period of ownership.

2. Where the associated disposal relates to an asset only a part of which was in use for the purposes of the business referred to in (1) above. Here, the just and reasonable restriction to the relief will be made by reference to the part of the asset that was used for business purposes compared to the part that was not so used.

3. Where the individual making the associated disposal was not involved in the carrying on of the business (whether this was personally, as a partner, or as an employee or officer of the individual's personal company) throughout the entire period of ownership of the asset in question. Here, the just and reasonable restriction to the relief will be made by reference to the length of the period for which the individual was involved in the carrying on of the business when compared to the entire period of the taxpayer’s ownership.

4. Where the associated disposal relates to an asset which, for the whole or part of the period falling after 5th April 2008, was made available use for the purposes of the business referred to in (1) above in consideration for the payment of rent to the taxpayer. Here, the just and reasonable restriction to the relief will be made by reference to the extent to which the rent paid (note: for periods after 5th April 2008 only). Unless the rent is shown to be less than the open market rent for the period, no entrepreneurs’ relief will be allowed. If the rent attributable to the period to be examined is shown to be less than the full market rent for the assets in question, relief shall be restricted on a pro rata basis.

‘Rent’ in relation to an asset for this purpose is defined at Section 169S(5) TCGA 1992 and includes any form of consideration given for use of the asset.

EXAMPLE 10

James retires from James DIY Ltd 6 April 2011, disposing of his entire shareholding therein under a company buy-back of own shares arrangement. This disposal crystallises a capital gain of £500,000 and because James has satisfied all the conditions, the capital gain will be charged at the lower rate of CGT under the entrepreneurs’ relief provisions. As regards the business premises, the position is as follows.

The business premises have always been owned personally by James. However, he agrees to sell the freehold property in question to the continuing directors giving rise to a capital gain of £800,000 assessable on him. This disposal sale also takes place on 6 April 2011.

Throughout his ten-year ownership of the freehold, James has received a rent from James DIY Ltd being 75% of the open market rent.

The proportion of the gain that may attract entrepreneurs' relief will be arrived at as follows:-

Total period of ownership:	120 months		
Period of ownership prior to 6 April 2008	84 months		
Period of ownership post 6 April 2008	36 months		
Proportion of £800,000 gain relieved without restriction	=	84/120ths =	£560,000
Proportion of £800,000 subject to restriction	=	36/120ths = £240,000	
Proportion of £240,000 attracting relief, i.e. 25% =			60,000
Total gain attracting relief			620,000

Gain not attracting entrepreneurs' relief 75% of £240,000, i.e. £180,000

EXAMPLE 11

Throughout Rowland's ten year ownership of his company's freehold premises, one-quarter of the property has been let by him to a third party while the remainder has been made available rent-free to his personal trading company.

On 31 July 2011, Rowland sells his entire shareholding in the company and his freehold interest in the property to an arm's length purchaser. Rowland makes a £3 million gain on the sale of the shares that fully qualifies for entrepreneurs' relief and a further gain of £1 million on the property sale.

Only three-quarters of the gain on the associated disposal, i.e. the freehold disposal, can attract entrepreneurs' relief. Thus, while of the gain £750, 000 will be taxed at the lower rate of 10% (as will the £3 million gain realised on the share disposal), the remaining gain of £250,000 will be taxed at 28%.

Chapter 5: Trust Gains

This chapter explores the aspects of entrepreneurs' relief insofar as its limited application to capital gains realised by trustees. The provisions are set out in Section 169J TCGA 1992.

The key fact to understand is that trustees' gains can only benefit from entrepreneurs' relief where there is a 'qualifying beneficiary'(defined below) who is both personally involved in the ownership and conduct of a business and is prepared to surrender all or part of his lifetime entrepreneurs' relief allowance (currently £5million but see Chapter 6). The surrender by the beneficiary is required because there is no separate allowance for trustees. In short, in a situation where there is only one qualifying beneficiary of a trust and he has already used his lifetime allowance against personal gains, it is not possible for the trustees to enjoy further relief.

There are two situations where a capital gain realised by trustees may benefit from relief (i.e. may benefit from a beneficiary surrendering part of his lifetime entitlement to the trustees), namely:

- certain share disposals by trustees
- certain disposal of other business assets by trustees.

However, it is important to note that relief will not be available where the trustees realise a capital gain in respect of a business asset where the unincorporated business in which that asset is used is carried on by them as a body. Even where a qualifying beneficiary works full-time in a business carried on by the trustees, capital gains made by the trust on business assets owned by it will not benefit from entrepreneurs' relief.

It is also important to note that, due to the definition of qualifying beneficiary (see below), to the extent a trust is discretionary entrepreneurs' relief will not be available to the trustees.

Furthermore, the beneficiary in question must be willing to assign to the trustees the relief that he might otherwise be able to use on another occasion. This is done by requiring the trustees and the qualifying beneficiary to jointly elect to claim entrepreneurs' relief against the trust gain in question. Each beneficiary's decision needs careful consideration because, in some cases, a clear conflict of interest will exist requiring the beneficiary to seek separate advice in the matter.

The following summarises the position.

Share disposals by trustees

Where there is a:

1. a qualifying beneficiary (with all, or part, of his lifetime allowance unused) , and
2. the trustees dispose of shares in a company, and
3. where, throughout a period of one year ending not earlier than three years before the date of the trustees share disposal,
4. the company in question was a trading company (or the holding company of a trading group), ***and***
5. the company (or a group member) either employed the qualifying beneficiary or he was an office holder thereof, ***and***
6. the qualifying beneficiary held personally at least 5% of the ordinary shares in the company with the shares in question entitling him to exercise at least 5% of the voting rights in the company - thus making it his 'personal company',

entrepreneurs' relief may be claimed in respect of the capital gain arising (see example below). As indicated, this will be subject to his willingness to do so and trustees should be advised to proceed with caution at all times in this matter.

From the above it will be appreciated that where the beneficiary in his personal capacity owns less than 5% of the shares, entrepreneurs' relief will not be available to the trustees.

Business asset disposals by trustees

Where there is a:

1. a qualifying beneficiary (with all, or part, of his lifetime allowance unused) , and

2. either:
    a. throughout a period of at least one year ending on the asset(s) disposal by the trustees, , or
    b. throughout a period of at least one year ending within the three year period ending on the asset(s) disposal in question,

    the asset in question has been in use for the purposes of a business carried on by the qualifying beneficiary, and

3. the qualifying beneficiary either ceases to carry on the business in question at the time of the asset disposal or has done so not more than three years earlier,

entrepreneurs' relief can be claimed in respect of any capital gain arising (after deducting any losses on the business asset disposed of at the same time) if,

4. the qualifying beneficiary has unused all or part of his lifetime allowance, and

he is willing to assign all or part of the benefit thereof to the trustees by joining in the claim by the trustees to utilise the appropriate part of his lifetime relief. Detailed rules are to be found in Section169J covering situations where there exists more than one beneficiary and where some beneficiaries are eligible beneficiaries and other beneficiaries are not.

Practical aspects of claims

It should also be noted that the joint claim must be made on or before the first anniversary of the 31 January following the tax year in which the disposal in question takes place, in other words not later than the second 31 January following the tax year in which the disposal takes place. This may cause practical problems as regards beneficiaries seeking independent advice as to the wisdom of joining in such a claim. Where there is more than one eligible beneficiary, a separate claim must be made by the trustees and each eligible beneficiary and careful attention must be paid in preparing subsequent trust accounts as regards allocation of capital.

It should also be noted that where a claim is made in respect of a trust gain realised on a particular asset, it does not appear possible to specify a level of relief to be utilised other than the maximum amount available.

Meaning of 'qualifying beneficiary' Section 169J(3)

Before trustees can claim relief on a disposal made by them there must exist a 'qualifying beneficiary' at the time of the trust asset disposal. An individual is a qualifying beneficiary if he or she has, under the terms of the settlement, an interest in possession (otherwise than for a fixed term) in:

(a) the whole of the settled property, or

(b) a part of the trust property that consists of or includes the settlement business assets disposed of (i.e. the part of the trust property to which the beneficiary's interest in possession exists, includes the trust assets giving rise to the gains referred to above).

The term ‘interest in possession’ is not defined within the provisions. Much has been written about this well-established tax term and a detailed analysis is outside the scope of this publication. However, see the case of Pearson & Others v CIR (1980 STC 318), which is the recognised case law on the matter. Broadly speaking a beneficiary with an automatic right to the income from all or some of the trust assets has an interest in possession in relation to those assets.

EXAMPLE 12

Kate is the sole beneficiary of the Kate Family Settlement and is entitled to receive the entire trust income.

She is a sole trader trading from 123 High Street, a freehold property owned by the trustees. She has traded for many years.

In January 2011, she received an offer from a public company that was willing to buy both the business and the premises. The offer is accepted and Kate retires from business. It has been calculated that Kate’s capital gain on the disposal of her business is £600,000 and that the trust gain will be £1,000,000.

Kate agrees to make a joint election with the trustees and so entrepreneurs’ relief will apply to the £1 million trust gain. She also makes a separate claim in respect of her personal gain and so entrepreneur’s relief will apply to her £600K gain. Both gains will benefit from the lower capital gains tax rate of 10%.

Both claims must be made to HMRC before 31 January 2013.

EXAMPLE 13

John is a director of GHQ (1984) Ltd, a trading company, and he owns 20% of the ordinary shares therein. This has been the case for many years.

The remaining shares have been held for many years by his family trust.

On a sale of the entire share capital of the company in June 2011, the following capital gains are realised:

- John £800,000
- Trustees £4,000,000.

John has not utilised any part of his lifetime allowance of entrepreneurs’ relief and so he can claim the relief against his personal gain so as to reduce the rate of tax to 10%. In addition, he can if he wishes join in a claim with the trustees whereby the balance of his lifetime allowance is made available to reduce the tax on the trust gain from 28% to 10%. This will leave John with £200,000 of his lifetime allowance available against future gains.

Part Two

Entrepreneurs' Relief: How it reduces the tax payable

Chapter 6: How entrepreneurs' relief reduces the tax payable

Introduction

Although entrepreneurs' relief operates only from 6 April 2008, a major change was introduced by Finance (No 2) Act 2010, which had effect from 23 June 2010. Not only was the amount of the relief available increased substantially for disposals on or after 23 June 2010 but there was also a major alteration to the manner by which the relief is have effect.

In summary, gains attracting entrepreneurs' relief during the period 6 April 2008 to 22 June 2010 inclusive are to be reduced by 4/9ths in order to arrive at the chargeable gain in respect of the disposal. However, gains attracting entrepreneurs' relief in respect of disposals on or after 23 June 2010 are to attract a reduced rate of capital gains tax, namely 10%.

In broad terms, the effect of Finance (No 2) Act 2010 described above is tax-neutral. The rate of 18% applied prior to 23 June 2010 and, if one reduces a gain by 4/9ths before charging it to tax at 18%, this gives rise to an effective rate of tax on the gross gain of 10%, i.e. to the same rate applicable to gains arising after 22 June 2010. Despite the foregoing, in order to consider the impact of entrepreneurs' relief in given situations, it is most straightforward to separately analyse the old rules and the new rules.

Lifetime allowance

Before proceeding further, it is necessary to remind ourselves that, unique among the CGT reliefs, entrepreneurs' relief is a relief that is subject to an overriding limit. This is referred to in practice as the taxpayer's lifetime allowance, i.e. an overriding limit on the quantum of the relief claimable by any one individual (or surrendered by him to a trust in which he has an interest in possession). This can be summarised as follows:-

- For the period 6 April 2008 to 5 April 2010 maximum gains that could benefit from entrepreneurs' relief was £1 million.
- For gains realised on disposals during the period 6 April 2010 to 22 June 2010, the lifetime limit was increased to £2 million.
- For disposal made on or after 23 June 2010, gains of up to £5 million during an individual's lifetime can be benefit from the remodelled relief.

Finance (No 2) Act 2010 remodelled nature of the relief in respect of disposals made after 22 June 2010 as well as the extent thereof. The following summarises the position and the impact of the Finance (No 2) Act charges.

Formal Claims

There is no automatic entitlement to entrepreneurs' relief simply because all the qualifying conditions have been met in relation to a given disposal. The taxpayer must submit a formal claim within the time limit laid down in Section 169M, subsection 1 thereof which states entrepreneurs' relief is to be given only on the making of a [valid] claim.

It should that the claim must be made on or before the first anniversary of the 31 January following the tax year in which the disposal in question takes place, in other words not later than the second 31 January following the tax year in which the disposal takes place.

Disposals Attracting Entrepreneurs' Relief: Post 22 June 2010

Section 169N TCGA 1992, as revised by Finance (No 2) Act 2010, requires that, on any qualifying business disposal where entrepreneurs' relief is claimed, the gains on the different assets are aggregated (see special rule for situations where one or more losses arise on the business disposal). Section 169N(1) requires that the aggregate amount of the gains on the assets in question be treated as if it were a chargeable gain arising on a single disposal. It is this gain (possibly net of losses – see below) to which the 10% rate of capital gains tax is to potentially be applied.

Because the entrepreneurs' relief is currently limited to qualifying gains of £5 million by the lifetime allowance, Section 169N also provides that, if there exists earlier relevant qualifying business disposals, it is necessary to deduct reduce the £5 million ceiling on the relief by the aggregate of:

- any earlier gain made by the taxpayer and subjected to the reduced rate of CGT (10%) in relation to gain made after 22 June 2010, and
- any gain in respect of the individual already subject to reduction under subsection Section 169N as it operated prior to 23 June 2010 (see below).

The fact that the maximum relief was utilised on an earlier disposal, i.e. before the current £5 million maximum came into operation, does not present further relief being claimed on a later disposal, i.e. at a time when the maximum level of relief has been increased.

EXAMPLE 14

Say, Terry makes two disposals attracting entrepreneurs' relief. Terry sold his holding in Terry 2207 Ltd on 29 March 2010. He realised a capital gain of £2,200,000. He claimed entrepreneurs' relief and so paid tax as follows (ignoring the annual exemption utilised against other gains).

First Disposal *(Gain £2,200,000)*

• £1,000,000 reduced by £444,445 (4/9ths) to £555,555 Tax @ 18%	= £100,000
• £1,200,000 taxed @18%	= £216,000
	£316,000

Second Disposal (*Gain £4,500,000)*

Say, on 30 June 2012 Terry sells his shares in Terry's Thyme Travel Ltd realising a gain of £4,500,000 on which entrepreneurs' relief is again available. Here, Terry's £5 million entrepreneurs' relief ceiling is reduced by £1 million claimed in 2009/10 to £4 million. Accordingly, Terry's gain is taxed as follows:

• £4,000,000 taxed @10%	= £400,000
• £500,000 taxed @28%	= £140,000
	£540,000

Business disposals crystallising losses

Section 169N requires that the losses realised in relation to any business disposal must be deducted from the gain otherwise attracting entrepreneurs' relief. This applies whether the disposal comprise different classes of shares in a company or different assets comprised in the disposal of an unincorporated business. The following example demonstrates the position.

EXAMPLE 15

Nigel disposes of his entire interest in The Tower Restaurant. The sale of the business freehold will crystallise a capital gain of £2,000,000, due to its development value, but Nigel is set to make a loss on the goodwill purchased by him in the year 2000 at a cost of £500,000.

Under Section 169N the gain of £2, 000,000 will be reduced by £500,000 and accordingly the gain attracting the 10% rate of capital gains tax will apply to the sum of £1,500,000.

The treatment of losses demonstrated above in mandatory. References above to losses are to allowable losses and assume a formal notification is made as required. It should not be overlooked that the set-off of losses is restricted where an asset is disposed of to a connected person. For example, unless all the assets are sold to the same connected person, the restriction in Section18(3) TCGA 1992 will operate so that the loss arising on a disposal of one of the business assets to a connected person will only be available for set-off against gains realised on other transactions with that same person.

The treatment of losses brought forward is dealt with on page 25.

Disposals Attracting Entrepreneurs' Relief: Pre 23 June 2010

The entrepreneurs' relief provisions introduced by Finance Act 2008 sought to achieve a reduction of the tax payable on gains attracting entrepreneurs' relief by reducing the amount of the gain otherwise assessable by a fraction of 4/9^{ths} - thereby leaving 5/9^{ths} assessable. With the short-lived operation of the of the flat 18% rate of CGT during the period 6 April 2008 to 22 June 2010 it was possible to create an effective 10% rate of CGT by charging only 5/9^{ths} of the otherwise assessable gain at 18%, (e.g. 5/9^{ths} of £100 taxed at 18% = £10.00).

Lifetime allowance

As indicated above, the relief applied only to the first £1 million of eligible gains for the period 6 April 2008 to 5 April 2010 but this was doubled to £2 million for the period 6 April 2010 to 22 June 2010 inclusive. It was the gross gain before the 4/9^{ths} assessable that is measured when establishing the unused lifetime allowance.

However, Finance (No2) Act 2010 did not alter the fundamentals of the entitlement to the relief (as opposed to the quantum thereof and the method by which it was given). The earlier chapters of this summary apply equally to the pre 23 June 2010 position as they do to later years.

EXAMPLE 16

Kate disposes of the nightclub she has run for many years and makes a capital gain on the goodwill of £1,800,000. No other assets are involved in the sale that give rise to either a capital gain or an allowable loss. The business premises are leased and the lease is assigned without a premium.

Kate's disposal date was 30 April 2010, i.e. before Finance (No 2) Act 2010 had effect. On the assumption that all the requirements of the relief had been met as at the date of disposal, Kate's assessable capital gain and CGT liability would be as follows:

Disposal 30 April 2010	£
Gain before entrepreneurs' relief	1,800,000
Less entrepreneurs relief reduction 4/9^{ths}	800,000
Amount assessable after entrepreneurs' relief	1,000,000
Less Annual Exemption	10,100
Charged to tax at 18%	898,900
Tax payable	178,182

It will be noted that, had the disposal taken place after 22 June 2010, the tax payable will have become as shown below, the only difference being the impact of the annual exemption.

Say Disposal 30 June 2010	£
Gain before entrepreneurs' relief	1,800,000
Less Annual Exemption	10,100
Charged to tax at 10%	1,789,900
Tax payable	178,990

Note: The difference in the tax payable reflects the fact that the value of the £10,100 annual exemption has fallen where it is setoff against gains attracting entrepreneurs' relief post 22 June 2010. Prior to 23 June 2010 the maximum tax saving from the annual exemption is @ 18% whereas subsequent thereto the maximum relief is at 10%. The Finance (No2) Act allows the annual exemption to be set against gains chargeable to tax at 28% in preference to the lower rate if such gains exist and the 2010/11 self-assessment return is completed accordingly.

Multiple Disposals - before and after an increase in the lifetime allowance

As explained in earlier chapters, it is possible for more than one disposal to arise in connection with a person deciding to cease a business and a question can arise as to the application of the different provisions and/or the varying lifetime allowance.

The following example demonstrates the position where there is more than one disposal which attracts relief but the disposals fall at different times.

EXAMPLE 17

After many years of trading, Simon sells his business on 3 March 2010 and crystallises a capital gain on the goodwill of 1.2 million.

Having ceased to trade, Simon obtains planning consent to redevelop his former premises and sells part of the premises on 15 June 2010 crystallising a gain of £1.8million. He sells the balance of the land and buildings used in his business at the date of its cessation on 31 March 2011 realising another capital gain of £3.5 million. Both these sales take place not more than 3 years after the cessation of the business previously carried and are, therefore, potentially qualifying disposals.

Here the initial £1 million ceiling will apply to the 2009/10 capital gain, leaving a gain assessable (after the maximum 4/9^{ths} reduction of £444,445) of £755,555. The relief on the initial post-cessation disposal will be restricted to the then maximum £2m lifetime allowance (as reduced by the £1 million relief claimed in 2009/10), i.e. restricted to a 4/9^{ths} reduction, being £444,445, leaving £1,355,555 assessable at 18% in 2010/11.

In addition, the second post cessation disposal, falling post 22 June 2010, will benefit from the £5 million lifetime allowance – as reduced by the aggregate relief (£1 million plus £1 million) on the earlier disposals. Under the remodelled relief, of the £3.5 million gain, £3 million will be chargeable at the reduced CGT rate of 10% and the balance of £500,000 will be chargeable at 28%.

Interaction with other CGT Reliefs

The position here differs depending upon whether the disposal in question falls before 22 June 2010 or at a later date. Because the entrepreneurs' relief given on disposal falling post 22 June 2010 takes the form of a reduced rate of CGT on gains of up to £5 million, the interaction issues are reasonably straightforward. However, because the relief in respect of disposals which took place on or before 22 June 2010 is given in the form of a reduction in the gain otherwise assessable (4/9^{ths}) careful thought is required. The following call for comment.

- **EIS Deferral Relief: Schedule 5B TCGA 1992**

In addition to the issues arising out of the remodelling of entrepreneurs' relief by F (No 2) Act 2010, a new interaction measure was specifically introduced to as to prevent taxpayers from claiming both EIS deferral relief (under Schedule 5B TCGA 1992) and entrepreneurs' relief.

Schedule 5B(1)(5A) specifically excludes from the gains which can be deferred under EIS deferral relief 'a gain so far as it is chargeable to capital gains tax at the rate in Section 169N(3)'. By definition, this must be a post 22 June 2010 gain. The individual must choose between deferring tax which will ultimately become payable at 28% (unless the taxpayer dies still owning the EIS shares) or paying tax at the reduced rate of 10% on the normal due date.

While prior to 23 June 2010, it was possible to use entrepreneurs' relief to reduce an individual's capital gain and the claim EIS deferral relief to postpone the 18% tax on the 5/9^{ths} otherwise left in charge, the taxpayer must now choose whether to defer tax or pay the reduced rate.

It is only to the extent that entrepreneurs' relief is not available, e.g. the extent to which the gain exceeds the £5 million lifetime allowance, that EIS deferral relief can still apply. The gain eligible for entrepreneurs' relief is treated as a separate gain from that which does not attract the relief – the latter being taxed at 28%. Obviously, to the extent that entrepreneurs' relief does not apply, the gain being deferred will be taxable at the rate of 28% of the gain.

Any gain deferred under the EIS deferral relief provisions will ultimately fall to be assessed (unless the investor dies owning the asset). Subject to a special transitional provision (see below) gains relating to original disposals prior to 23 June 2010 but deferred until on or after 22 June 2010 will be liable at the 28% CGT because entrepreneurs' relief cannot apply to the gain assessable at the point deferment comes to an end.

As regards pre-6 April 2008 gains deferred under Schedule 5B, a special transitional measure was included in schedule 3(8) Finance Act 2008. This introduced a provision whereby, on the first occasion on which pre-6 April 2008 deferred gain becomes taxable (in whole or in part) after 5 April 2008, the taxpayer can elect for the transaction which gave rise to the deferred gain to be examined to ascertain whether, if the transaction in question had taken place on 6 April 2008, entrepreneurs' relief would have been claimable. If so, and assuming the necessary election is made, the deferred gain can benefit from entrepreneurs relief. The election must be made not later than the second 31 January following the end of the tax year in which the first occasion under which the deferred gain becomes chargeable arises, e.g. the sale of some of the shares. Under this transitional provision, the form of the relief is determined by the date of the event triggering the assessable gain. Thus, if any part of gain deferred from 2005/06 first becomes assessable in the period ending 22 June 2010, and the conditions under this transitional measure are satisfied, the gain will be reduced by 4/9^{ths}. Any part of the gain falling to be assessed on a date falling after 22 June 2010 will attract the reduced rate of CGT (rather than being reduced by 4/9^{ths}). A similar position arises in respect of gains deferred following the making qualifying investments in VCTs (prior to the abolition of Schedule 5C TCGA 1992 on 6 April 2004).

- **Holdover relief: Section 165 & 260 TCGA 1992**

As regards disposals after 22 June 2010, in situations where the entire gain is held over, say under Section 165, clearly no gain is left in charge and, therefore, there is no benefit to be obtained by claiming entrepreneurs' relief. However, where the level of holdover relief is such that part only of the gain on a business disposal is held over and a balance is left in charge, (e.g. where there is actual consideration paid to the transferor which exceeds the base cost of the asset in question), the balance of the gain left in charge can benefit from the 10% rate of CGT where the appropriate entrepreneurs' relief conditions have been met.

As regards the situation in respect of disposals that took place during the period beginning 6 April 2008 and ending on 22 June 2010 inclusive, here HMRC's view was that entrepreneurs' relief could not be claimed where the full gain was to be held over. Thus, the acquiring party took on the gross gain without reduction for entrepreneurs' relief. To the extent a gain could only be partly held over, the 4/9^{ths} reduction could be applied to the balance of the gain left chargeable where the appropriate entrepreneurs' relief conditions have been met.

- **Rollover relief: Section 152 TCGA 1992**

As regards disposals after 22 June 2010, in situations where the entire gain is rolled over under Section 152, clearly no gain is left in charge and, therefore, there is no benefit to claiming entrepreneurs' relief. Where part only of a gain is rolled over and the balance is left in charge, the chargeable amount can benefit from the 10% rate of CGT where the appropriate entrepreneurs' relief conditions have been met.

As regards disposals that took place during the period beginning 6 April 2008 and ending on 22 June 2010 inclusive, where rollover relief applied, entrepreneurs' relief could not be claimed where the full gain was to be rolled over. However, where part only of a gain is rolled over and the balance is left in charge, the 4/9ths reduction can be applied to that balance, i.e. where the appropriate entrepreneurs' relief conditions have been met in respect of the disposal in question.

There is nothing to prevent a rolled over gain from attracting the 10% rate of CGT if the replacement asset (see section 152) is disposed of in a manner which allows entrepreneurs' relief to be applied to the gain arising on the assets comprised in the subsequent disposal of the business.

- **Set-off of losses not comprised in the business disposal**

As already indicated, losses comprised in the business disposal must be set against the gains arising so that the net gain only attracts entrepreneurs' relief. In effect, loss relief in respect of such assets is limited to the 10% rate. However, other losses can be set off against gains in the tax year to best suit the taxpayer. F(No 2)A 2010 introduced a new measure to permit such flexibility. See Section 4B TCGA 1992. Accordingly, with effect from 2010/11, where a taxpayer has allowable losses (not already taken into account in calculating his entitlement to entrepreneurs' relief) and he has both gains taxable at the reduced rate of CGT and also at higher rates (currently 18% of 28% for the year 2010/11), the taxpayer can set the losses of to his advantage.

> **EXAMPLE 18**
>
> Kay disposed of her holding of shares in KK Ltd realising a gain of £1 million on 31 January 2011. The full gain qualifies under the entrepreneurs' relief provisions and is, as such, liable to tax at the reduced CGT rate of 10%.
>
> In 2010/11 Kay also realised losses on an investment in XYL Ltd. The loss claimed is £100,000.
>
> In 2010/11, Kay also realised a £80,000 capital gain on the sale of some land held for many years as an investment and which had always been let by her to a third party. This gain is liable at the CGT rate of 28%.
>
> Kay is able to set her loss against the capital gain taxable at 28% first and then set only the balance against the gain liable at 10%.

Deferred Gains Involving QCB

Where Section 116(10) TCGA 1992 operates in respect of a transaction where shares are exchanged, whether in whole or in part, for a qualifying corporate bond (QCB), and the gain attributable to the value of the QCB is deferred, it is necessary to consider whether the 'share-for-QCB exchange' took place:

1. On or after 23 June 2010 ,
2. Between 6 April 2008 and 22 June 2010 (inclusive), or
3. Before 6 April 2008.

The position can be summarised as follows.

Share-for-QCB exchanges on or after 23 June

Where Section 116(10) TCGA 1992 applies in respect of a share-for-QCB exchange on or after 23 June 2010, so as to defer the assessment of a gain, the individual has a stark choice.

- If the taxpayer believes the gain would if assessable qualify under the entrepreneurs' relief provisions and so all or part of it would be liable to tax at the 10% rate of CGT, he can opt to elect for section 116(10) to be disapplied. Instead the gain will be assessed and, as a result, pay whatever tax arises in respect of the tax year in which the exchange takes place. This election must be made not later than the first anniversary of the 31 January following the tax year in which the exchange takes place.

- Alternatively, the individual can let Section 116(10) operate so that assessment of the gain is deferred until the QCB is redeemed, paying the appropriate CGT rate at that point. In many cases, entrepreneurs' relief will not be available in the year of encashment and so the CGT rate applicable to the deferred gain will be 28%.

Share-for-QCB exchanges between 6 April 2008 and 22 June 2010

A more generous and taxpayer friendly position existed in respect of a share-for-QCB exchange which took place during the period between 6 April 2008 and 22 June 2010. Here, the taxpayer could make an election to claim entrepreneurs' relief in respect of the deferred gain, reducing it by 4/9^{ths} yet still leaving the reduced gain to be deferred until encashment of the QCB arises.

Gains deferred in this manner will be assessed at the 28% CGT rate (assuming the taxpayer's income makes him liable to higher rate tax) and thus the effective rate of tax becomes 15.56% (i.e. 5/9^{ths} of the actual gain taxed at 28% = 15.56%).

Share-for-QCB exchanges prior to 6 April 2008

A special transitional provision was introduced to cover situations where a share-for-QCB exchange took place before 6 April 2008 (i.e. before the introduction of entrepreneurs' relief) and the gain remained deferred as at 6 April 2008. In short, schedule 3(6) Finance Act 2008 introduced a provision whereby a pre-6April 2008 gain, deferred under section 116(10) in these circumstances, could be treated as though it were a gain on 6 April 2008. If the taxpayer could show that on that date he met all the conditions of the relief, the deferred gain would be reduced by 4/9^{ths}. To enjoy this transitional provision, a claim must be made no later than the second 31 January following the end of the tax year in which the first 'relevant disposal' occurs. The relevant disposal is the first occasion after 5 April 2008 when the QCB is redeemed. If there is a series of redemptions, the time limit will be determined by the first such redemption. Under this provision, the gain as reduced by 4/9^{ths} is charged to the appropriate rate prevailing at the time of the encashment of the bond. Thus, the actual gain deferred following the acquisition of a QCB acquired on a share-for-QCB exchange in May 2007 and first encashed in July 2011, will ultimately be taxed at an effective rate of 15.56% if the claim is made before 31 January 2014 - assuming the CGT rate remains at 28%.

Paper-for-paper disposals: Disapplication of section 127

Section 169Q addresses the situation where the so-called 'paper for paper' rules operate on share exchanges but the likelihood is that the shareholder will not be in a position to claim entrepreneurs' relief in respect of his new holding of shares or securities.

Where a new holding shares or securities received in exchange for a holding of shares or securities previously held in a company Section 127 operates to deem both the old holding and the new holding to be the same asset. Circumstances will often arise where, had there been a cash disposal (rather than a paper-for-paper transaction), any capital gain arising would attract entrepreneurs relief.

Section 169Q(2) enables an election to be made for the paper-for-paper rules to be disapplied. As a result, the exchange gives rise to a capital gain (based upon the value of the consideration given for the old shares) which will be taxable but the tax payable can be reduced by entrepreneurs' relief. The election works on an 'all or nothing basis' and this appears so even though the amount chargeable is substantially in excess of the maximum relief.

An election must be made if Section 169Q is to operate to disapply section 127. The election must be made on or before the second 31 January following the end of the tax year in which the paper-for- paper transaction takes place.

Section 169Q elections in respect of shares held by trustees must be made jointly by the trustees and the qualifying beneficiary concerned (see Chapter 5). Such joint elections must be made before the second 31 January following the end of the tax year in which the paper for paper transaction takes place. Elections by individuals must be made within the same time limit.