Written evidence submitted by the Association of Taxation Technicians (ATT)

Finance (No 3) Bill 2017-19: Clause 38, Schedule 15 Entrepreneurs' Relief

A. Executive summary

1. Clause 38 and Schedule 15 include a number of provisions to amend Entrepreneurs' Relief (ER) from 6 April 2019 including:

   1.1. Enabling individuals whose shareholdings are 'diluted' below the 5% qualifying threshold following a further issue of shares as part of a fundraising exercise to retain ER on the gain on their shares up to the point of dilution. Without the provision, once their holding dropped below 5%, the individual would lose any entitlement to ER.

   1.2. Extending the minimum period of time that the entrepreneur has to hold assets for ER to be available on disposal from one year to two years.

2. We consider that there may be unintended consequences to the operation of these changes:

   2.1. We are concerned that the requirement that the new shares which cause the dilution are not being issued or subscribed for as part of arrangements to secure a tax advantage by any person could be more restrictive than intended, capturing, for example, use of the Enterprise Incentive Scheme (EIS) in the way intended by government.

   2.2. Where an entrepreneur sells shares in a company where there has been a reorganisation or restructuring of the company, we are concerned that in some circumstances the entrepreneur could unjustly fail the test of having been an officer or employee of the company for two years prior to sale. The issue has been resolved when an entrepreneur incorporates during the qualifying period, but not where a company is restructured.

3. We have expanded on our concerns on the dilution point in section B below and on the reorganisation issue in section D. Suggested remedies can be found at sections C and E respectively.

B. Impact of restrictions on dilution measures

4. The legislation as set out at s169SC paragraphs 5 and 6, included in the appendix to this note, prevents the entrepreneur benefiting from this extension to ER in any situation where the shares which trigger the dilution are issued as part of *arrangements* where the main purpose, or one of the main purposes, is the securing of a *tax advantage* to *any person* in respect of capital gains tax, corporation tax or income tax.

5. It is quite possible that a business, in genuine need of finance, may attract investors who are interested in obtaining as one of their main purposes other benefits such as a CGT, Income Tax or Corporation Tax relief either immediately or in the future. There are several tax reliefs which are designed to incentivise subscription for shares in limited companies, for example, the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS). It seems contrary to

the policy principle behind the Schedule 15 measure if the existing shareholder ("E") could not benefit from the measure because an unconnected new shareholder ("N") (whose investment was causing the dilution of E's shareholding) happened to be able to benefit from the straight-forward use of a mainstream tax relief designed precisely for the purpose of encouraging such investment.

6. Our concern is that the intention of the investor to benefit from one of these existing, or any future, reliefs is capable of constituting an *arrangement* within the meaning of the proposed legislation which would deny the entrepreneur their intended relief on dilution. Furthermore, the *entrepreneur* may not even be in the position to know what arrangements the *investor* is making to know if this restriction applies.

C. Suggested remedies for dilution measures

7. We suggest that it is sufficient for the test in s169SC(5)(b) to be whether or not the relevant share issue is for genuine commercial purposes only – i.e. that the business has need of the funds. Whether or not one of the investors in the share issue has an intention to benefit from another tax consequence to which they are legitimately entitled should not be relevant to the ER position of an existing shareholder who is suffering dilution.

8. Alternatively, the test of what constitutes an *arrangement* and a *tax advantage* needs to be modified to confirm that if the subscribing individuals or entities wish to benefit from existing or future tax reliefs designed to encourage investment - such as EIS or SEIS - this will not result in the entrepreneur whose holding is diluted being unable to benefit from the extended ER provisions introduced by Schedule 15.

9. Failing that, we would ask for confirmation in the relevant guidance that the type of situation identified above is not intended to be caught by the anti-avoidance provisions. Of the options suggested, this would be our least preferred approach as we would prefer to see clarity in the legislation itself.

D. Impact of extended period of qualification on reorganisations

10. As part of a reorganisation, an entrepreneur may be issued with shares in a new company (NewCo) in exchange for their existing shares in a company (OldCo). Provided that certain conditions are met, the shares in NewCo are considered for tax purposes to 'stand in the shoes' of OldCo. This means, for example, that a minimum ownership period for NewCo can be met by aggregating the entrepreneur's ownership of NewCo with that of OldCo.

11. However, for ER purposes, the entrepreneur is also required to have been an officer or employee of the company for two years prior to sale. This requires them to have been an officer or employee of *NewCo* for two years. An entrepreneur may be unable to satisfy this requirement within two years of a reorganisation, even though their employment with OldCo and NewCo might equal or exceed the two-year requirement.

12. The issue has been addressed in Finance (No. 3) Bill where an entrepreneur has *incorporated* in the two-year period prior to sale by introducing paragraph 7ZA into section 169I. From 6 April 2019, the requirement for the entrepreneur to have been an officer or employee of the company

for two years will be met by taking into account the period when the entrepreneur owned the business pre-incorporation.

13. Therefore, where an entrepreneur starts in business as a sole trader or partner on 1 January 2018, incorporates 18 months later on 30 June 2019 and then sells their shares six months later on 31 December 2019, although the company has not been in existence for more than six months, the two year ownership and employment conditions are considered to have been met by taking into account the pre-incorporation period from 1 January 2018 to 30 June 2019.

14. However, where an entrepreneur acquires shares in OldCo and becomes an employee on 1 January 2018, then there is a restructuring on 30 June 2019 so that they exchange their shares in OldCo for NewCo and become an employee of NewCo, when NewCo is sold on 31 December 2019 the entrepreneur cannot take into account their period of employment with OldCo to meet the two year employment test.

15. We have raised this issue in representative body groups and been advised by HMRC that they would not, in practice, take this point and would therefore effectively allow the entrepreneur to take their period of employment with OldCo into account. However, we would strongly prefer that the position is addressed by legislation as otherwise the entrepreneur has no basis for their claim at tribunal. This is particularly important now that the qualification period for ER has been extended from one year to two years, as more entrepreneurs are likely to be affected.

E. Suggested remedy for reorganisation issue

16. We suggest that the new paragraph 7ZA to be inserted into s169I TCGA 1992 is amended and extended to make provision for reorganisations as well as incorporations. The entrepreneur should be able to add the time that they have been employed by OldCo towards the qualifying period of employment for NewCo for the purposes of the two year employment test. Our suggested wording is:

> *"If in any case where an individual disposes of any shares in a company where there has been one or more reorganisations, then the condition in subsection 6(b) is to be treated as met where the individual was an officer or employee of any of the companies comprising their earlier holding(s)."*

Appendix:

1. Definition of 'relevant share issue' as currently drafted in Schedule 15 – Section169SC

"(5) In this section -
"material disposal of business assets" and "personal company" have the same meanings as in Chapter 3 (see section 169S),
"relevant share issue" means an issue of shares by the company where—
(a) the shares are issued by the company for consideration consisting wholly of cash, and
(b) ***the shares are subscribed, and issued, for genuine commercial reasons and not as part of arrangements the main purpose, or one of the main purposes, of which is to secure a tax advantage to any person [emphasis added]****, and*
"relevant value" means—

(a) in relation to an asset consisting of shares, an amount equal to the consideration that would be apportioned to the asset if, immediately before the relevant share issue, the whole of the issued share capital of the company were sold for a consideration equal to its market value at that time, or

(b) in relation to any other asset, its market value at the time of the relevant share issue.

(6) For the purposes of the definition of "relevant share issue" in subsection (5)—

"arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable), and

"tax advantage" means—

(a) relief or increased relief from tax,

(b) repayment or increased repayment of tax,

(c) the avoidance or reduction of a charge to tax or an assessment to tax, or

(d) the avoidance of a possible assessment to tax,[emphasis added]

and for the purposes of this definition "tax" means capital gains tax, corporation tax or income tax.

The Association of Taxation Technicians

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Association of Taxation Technicians
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