

# Entrepreneurs' Relief Overview

## INTRODUCTION

This note outlines the key conditions applying to Entrepreneurs' Relief ("ER") in various circumstances. It is not designed to be a definitive statement of the qualifying conditions or tax treatment but instead is intended to provide an overview for discussion. It is based on the laws and judicial interpretation in force at the date of writing and is therefore subject to any changes in applicable tax laws and HMRC interpretations occurring after the date of this document.

If, having considered this guide, you would like to know more or to discuss your own circumstances in greater detail, please speak to your usual contact at Stevens & Bolton or a contact listed at the end of this guide.

## WHAT IS ER?

ER is potentially a very valuable relief from capital gains tax ("CGT") on the sale of shares or securities. It reduces the rate of CGT to 10% (down from 18% for basic rate taxpayers and 28% for higher/additional rate taxpayers). ER applies to the first £10 million of qualifying lifetime capital gains and is claimed via a taxpayers' self-assessment tax return.

## WHAT ARE THE QUALIFYING CONDITIONS FOR THE DISPOSAL OF SHARES?

In order to qualify for ER on shares, throughout the 12 months (ending on the date of disposal of the shares) a taxpayer must have:

- beneficially owned at least 5% of the ordinary share capital (by nominal value) of a trading company (or holding company of a trading group). Those shares must also carry at least 5% of the voting rights attributable to shareholders; and
- been an employee or director of that company (or another group company).

ER is also available on a disposal of shares (for example, on liquidation) if the company has ceased trading at the time of the disposal, provided that:

- the above conditions were satisfied for the period of 12 months before the date of cessation of trade; and
- the shares/securities are sold within 3 years of the date of cessation of trade.

## WHAT ARE THE QUALIFYING CONDITIONS FOR ER ON A SALE OF ASSETS?

ER will be available on the sale of the whole or part of a trade as a going concern owned by a taxpayer (whether as a sole trader or in partnership) for at least 12 months before the date of the sale, including:

- a sale by sole traders when converting to a partnership;
- a sale by partners in a partnership; and
- a partial sale by existing partners when a new partner joins a partnership.

ER is also available if the business has ceased trading at the time of the sale, provided that:

- the above conditions were satisfied for the period of 12 months ending on the date of cessation of trade; and
- the assets are sold within 3 years of the date of cessation of trade.

Gains from the sale of personal assets used by a trading company or partnership (for example, if you personally own the business premises and let it to your business) may also be eligible for ER if:

- the owner of the assets satisfies the ER requirements for a sale of the business/shares; and
- the owner of the assets is either reducing his share in the partnership capital by an amount equal to at least 5% of the assets of the partnership or reducing his shareholding in a company by 5% of the relevant share capital of the company.

Investments held by the business (e.g. shares) and assets not used as part of the trade will not qualify for ER.

## HOW DO DISPOSALS BY TRUSTEES DIFFER?

ER may apply if a trustee (or trustees) of a life interest trust sells the shares (or the business). However this will only apply where the life tenant of the trust is an employee or director of the company (or business) and holds at least 5% of the voting shares in his own right (or works in the business). The ER lifetime limit of £10 million refers to the beneficiary. Where qualifying capital gains are made on the same day by both the trustee and the beneficiary (as life tenant), the beneficiary has priority for ER.

## HOW DO I MAKE A CLAIM?

Claims for ER are made through the self-assessment tax return. This must be submitted to HMRC electronically by 31 January after the end of the tax year in which the relevant disposal took place.

## DOES ER APPLY TO DEFERRED CONSIDERATION?

If you qualify for ER in respect of the disposal of shares and receive consideration in the form of shares or loan notes, you may have to choose whether to defer the gain or to elect to tax the whole gain at the date of completion. You should take advice if this is the case.

If you receive deferred consideration and following the transaction you will no longer hold at least 5% of the company's ordinary share capital or that of the purchaser company and/or will not continue to be an employee or director of the company or group, you will not be eligible for ER on the subsequent sale of your consideration shares/loan notes.

You may choose to:

- elect out of the normal 'no disposal' rules, thereby triggering a disposal on which ER could be claimed. This would enable a taxpayer to apply ER to not only the cash element of the consideration but also any consideration shares/loan notes. This typically tends to give rise to a higher tax charge upfront but an overall lower tax bill in the longer term; or
- not elect out of the 'no disposal' rules and make a claim for ER only on the consideration received at the date of completion in your self-assessment tax return, and pay the main rate of CGT (18% for basic rate taxpayers and 28% for higher rate taxpayers) on the deferred consideration once you receive it.

In a transaction involving an earn-out (where some of the consideration is deferred and contingent on the future performance of the target company) you should consider taking specialist advice in order to optimise your capital gains tax position.

## CAN ER BE CLAIMED FOR SHARE OPTIONS?

Shares acquired following the exercise of Enterprise Management Incentive ("EMI") scheme options may qualify for ER even if the option holder does not acquire 5% or more of the company's ordinary share capital. There are a specific set of ER qualifying requirements which apply to the disposal of shares acquired on the exercise of EMI options which should be considered where shares have been acquired under EMI.

## CAN GAINS BE CARRIED FORWARD INTO THE SEED ENTERPRISE INVESTMENT SCHEME ("SEIS") OR THE ENTERPRISE INVESTMENT SCHEME ("EIS")?

Gains of up to £100,000 may be invested into SEIS to obtain partial (50%) exemption from CGT.

Gains which are eligible for ER may be deferred into EIS investments and can keep their eligibility for ER once the EIS investment is realised.

## WHAT ARE THE COMMON PITFALLS?

Common scenarios where ER is lost are:

- you leave employment/office for whatever reason prior to selling the assets/shares;
- later dilution of the company's share capital (i.e. fresh issues of shares) which takes your shareholding below the required 5%; or
- future amendments to voting rights or the rights of the relevant class of shares held which takes your voting rights below the required 5%.

## CONTACT US

For further information about any of the issues raised in this guide, please contact:



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*The information contained in this guide is intended to be a general introductory summary of the subject matters covered only. It does not purport to be exhaustive, or to provide legal advice, and should not be used as a substitute for such advice.*

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