

# Del's darling

The proposed entrepreneurs' relief: **SIMON MCKIE** considers whether this is a new initiative or a welcome throwback.

**A** DRAFT SCHEDULE – which is referred to as the 'new schedule' in this article – was published on 28 February 2008 implementing the new capital gains tax entrepreneurs' relief. The Chancellor had announced his intention (the 'press release') to introduce this relief on 24 January 2008. Publishing draft legislation which was to take effect only thirty eight days after its publication might well be criticised, but on a first look the relief is, itself, something of a relief. In contrast to so many recent HMRC releases, the press release turns out to have been a reasonably accurate description of the draft legislation which was to come. Although the legislation shows some of the deleterious effects of the new drafting style, it is on the whole quite clear and it is not marred by the excessive and obsessive anti-avoidance legislation with which HMRC normally nullify the benefits of new reliefs. Indeed, the draft legislation feels like a step back in time and that is exactly what it is. The press release said that it would be 'based broadly on the capital gains tax retirement relief'. One might object to the word 'broadly'. Much of the old retirement relief legislation has been taken over word for word from retirement relief and a similar structure has been used.

## The right model?

Before we give Mr Darling a gold star, however, one might question his choice of model. Other than the fact that it was a relief on disposals of business assets, there seems no connection between the aims of retirement relief and of entrepreneurs' relief. Entrepreneurs' relief is specifically not related to retirement and is designed to encourage entrepreneurship by giving small entrepreneurs the prospect of realising the value of their businesses at a low rate of tax regardless of when they do so. In that way its purpose is surely far closer to that of taper relief on business assets which it partially replaces. Both reliefs work by reducing otherwise chargeable gains by a percentage, although the exact mechanism by which they do so differs.

### KEY POINTS

- The relationship between entrepreneurs' relief and retirement relief.
- The claim; is it beneficial and the time limit.
- What is a qualifying disposal?
- The relevant conditions for relief.
- Calculating the relief.



Entrepreneurs' relief arose, of course, from the storm of protest which greeted the abolition of business asset taper relief so it is hard to understand why one would choose to base the relief on retirement relief rather than on business asset taper relief itself.

The result of doing so is that some who would have qualified for business asset taper relief on gains within the entrepreneurs' relief limit of one million pounds will not qualify for entrepreneurs' relief. Notably, the losers include employee shareholders with less than 5% holdings and owners of assets used in a business where the rules for entrepreneurs' relief are far more restrictive than those which apply for business asset taper relief.

In my experience, after the reforms of taper relief made by FA 2003, it was relatively easy to determine whether or not the subject of a disposal was a business asset for taper relief purposes. Retirement relief, however, was more uncertain in its application as the number of cases – twenty-one in the latest edition of *Tolley's Tax Cases* – reaching the Commissioners and the courts demonstrated.

It is hard not to feel that the adoption of retirement relief as the model for entrepreneurs' relief was studiously perverse.

## The claim for relief

Entrepreneurs' relief is given where a claim is made in respect of a qualifying business disposal. The claim must be made on or before the first anniversary of the 31 January following the tax year in which the qualifying business disposal was made.

Neither retirement relief nor taper relief had to be claimed because there were no circumstances in which they were not beneficial. Entrepreneurs' relief may not be beneficial in some uncommon circumstances where it

displaces a time limited relief such as enterprise investment scheme deferral relief. Where a relief will almost always be beneficial but may not be in limited circumstances, it makes more sense, rather than providing for a positive claim for the relief to apply, to provide for a negative claim for the relief not to apply as is done with incorporation relief under TCGA 1992, s 162. Furthermore, in relation to a relief which operates by reference to a lifetime limit, twenty-two months after the relevant tax year is too short a period to allow for the claim to be made. It would have been more appropriate to apply the default claim period of five years and ten months.

### Qualifying business disposals

A qualifying business disposal is:

- (A) a material disposal of business assets;
- (B) a material disposal of trust business assets; and
- (C) a disposal associated with a relevant material disposal (new TCGA 1992, s 169H(2)).

(A) roughly corresponds to retirement relief under TCGA 1992, s 163 and (C) to retirement relief under s 164(6).



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### A material disposal of business assets

A disposal of business assets for the purposes of (A) above is:

- (a) the disposal of the whole or part of a business;
- (b) a disposal of, or of interests in, one or more assets in use for the purpose of the business when the business ceases to be carried on; or
- (c) a disposal of, or of interests in, shares or securities of a company.

The inclusion of interests in shares or securities of a company is interesting. It is not at all clear to what it refers. It will surely cover joint interests and interests as a tenant in common but the interesting question is the extent to which it might also cover options, futures, derivatives and limited equitable interests. This is an area which will require further thought.

Special rules adapt this category of qualifying business disposals to partnerships.

An individual who disposes of assets, or interests in assets, used for the purposes of a business which he carries on in entering into a partnership is treated as disposing of part of a business. The disposal by an individual of the whole or part of the individual's interest in the assets of a partnership is treated as a disposal by the individual of, or

of part of, the business carried on by the partnership. The business carried on by a partnership is treated as owned by each individual partner.

Different rules apply to each of these three categories of disposals of business assets in determining whether or not there is a material disposal.

### The whole or part of a business

A disposal of the whole or part of a business is a material disposal if the business was owned by the individual throughout the period of one year ending with the date of the disposal.

In ordinary English usage, a business is an activity. One does not dispose of an activity. Rather one disposes of the assets used in the activity including know-how and other knowledge which can be protected by law and the right to hold oneself out as succeeding to the business. A 'disposal of ... a business', therefore, is only a loose shorthand for the disposal of all (or perhaps of most) of the assets used in a business. This imprecision of drafting caused considerable problems in construing the retirement relief legislation. It will do so again in relation to entrepreneurs' relief. A disposal of business assets for taper relief purposes is either a disposal of shares or of assets used in a business; a far less problematical formulation. Once again one wonders at the perversity of resurrecting past difficulties.

### One or more assets

A disposal of business assets within (b) is a material disposal if the business is owned by the individual throughout the period of one year ending with the date on which the business ceases to be carried on and that date is within the period of three years ending with the date of disposal. Again, these provisions mirror those of retirement relief under TCGA 1992, s 163(2)(b).

There was an unclear area of overlap between s 163(2)(b) and s 164(6) which also has an equivalent provision under entrepreneurs' relief in new section 169K which governs disposals associated with relevant material disposals. That area of overlap is wider in entrepreneurs' relief and no doubt this will be an area which will repay close attention from advisers.

### Shares or securities

A disposal of business assets within (c) above is a material disposal if certain conditions are met during either of the following two periods. The first period is the period of one year ending with the disposal. The second period is the period of one year ending with the time at which the company either ceases to be a trading company (without becoming or continuing to be a member of a trading group) or ceases to be a member of a trading group (without becoming or continuing to be a trading group).

The conditions which must be satisfied in either of these two periods are that the company in which the shares or securities subsist is the individual's personal company and is either a trading company or the holding company of a trading group and the individual is an officer or employee of the company or, in relation to groups, of one or more companies which are members of the group.

HMRC have published a set of ‘frequently asked questions’ (when were they asked one wonders?) in which they accept that there is no requirement for an officer or an employee to work any particular number of hours in the company. However, it should be remembered that it is unlikely that there can be an employment relationship where there is no defined requirement to spend at least a minimum amount of time on the duties of the employment and that a person who becomes an officer of a company takes on onerous responsibilities in relation to it.

A personal company for the purpose of entrepreneurs’ relief is defined by new TCGA 1992, s 169S(5) as a company in which the individual concerned holds at least 5% of both the ordinary share capital and the voting rights. Under retirement relief, the definition was less restrictive. It was only required that the individual should hold 5% of the voting rights. What is more, this is also the current definition of a personal company for the purposes of roll-over relief on business assets (TCGA 1992, s 157(b)). Why, one wonders was a more restrictive rule adopted for entrepreneurs’ relief?

### Disposals of trust business assets

The second class of qualifying business disposal is a disposal of trust business assets.

Under new TCGA 1992, s 169J there is a disposal of trust business assets where:

- (a) the trustees of a settlement make a disposal of settlement business assets;

- (b) there is an individual who is a qualifying beneficiary; and
- (c) the relevant condition is met.

### Settlement business assets

Settlement business assets are assets which form part of the settled property and which are either shares in or securities of a company or interests in such shares or securities or are assets (or interests in assets) used or previously used for the purposes of a business.

*The exclusion of interests for a fixed term is found elsewhere in our tax legislation and it reflects a peculiar obsession of HMRC’s collective mind.* ”

It should be noted that there is no relief for disposals of the whole or part of a business. HMRC seem to be under the impression that it is impossible for trustees to carry on a business. It may very well be imprudent for trustees to do so and professional trustees are unlikely to be willing to take on such trusteeships, but it is not uncommon for family trustees to run businesses particularly where the trust assets consist of farmland.

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### A qualifying beneficiary

An individual is a qualifying beneficiary if, under the settlement, he has an interest in possession otherwise than for a fixed term in the settlement business assets which are the subject of the disposal. The exclusion of interests for a fixed term is found elsewhere in our tax legislation and it reflects a peculiar obsession of HMRC's collective mind. After all, there is little practical difference between an interest for a fixed term coupled with wide powers to defeat and extend the interest and an interest for life subject to similar powers.



*The newly proposed entrepreneurs' relief is perhaps a modest relief. Nonetheless, it is a useful new relief for small businesses.*

### The relevant condition

In relation to disposals of shares or securities, the relevant condition is that throughout a period of one year ending not earlier than three years before the date of the disposal the company is the qualifying beneficiary's personal company and is either a trading company or the holding company of a trading group and the qualifying beneficiary is an officer or employee of the company or one of the group companies.

In relation to a disposal of assets used for the purposes of a business, the relevant condition is that the assets are used for the purposes of the business carried on by the qualifying beneficiary throughout a period of one year ending not earlier than three years before the disposal and that the qualifying beneficiary ceases to carry on the business on the date of the disposal or within the period of three years before that date.

Again it is notable that the legislation does not take account of the possibility that a trustee might act as an officer of the company in his capacity as trustee. It is, after all, not unusual for trustees holding family company shares to act as directors in that capacity.

Once again these provisions are extended to apply to partnership interests.

### Associated disposals

There is a disposal associated with a relevant material disposal if three conditions are met.

- The first condition is that an individual makes a material disposal of business assets which is a disposal of the individual's interests in the assets of a partnership or of the shares or securities, or interests therein, of a company. It should be noted that this relief is not available to trustees and does not extend to disposals associated with a material disposal of a business which is not carried on in partnership.

- The second condition is that the individual makes the disposal as part of his withdrawal from participation in the business carried on by the partnership or company or, if relevant, by a member of a trading group.
- The third condition is that throughout the period of one year ending with the earlier of the material disposal of the business assets and the cessation of the partnership or company's business, the assets concerned are used for the purposes of the business.

The relief on disposals associated with a relevant material disposal is restricted on a just and reasonable basis in various circumstances. They are that:

- (a) the assets are only partly used for the business during the individual's ownership period;
- (b) only part of the assets are so used;
- (c) the individual is concerned in the carrying on of the business for only part of the period for which the assets are used for the purposes of the business;
- (d) during some part of the period when the assets are used for the purposes of the business their availability is dependent on the payment of rent.

'Rent' for this purpose is defined as including any form of consideration given for the use of an asset and so this provision may deny entrepreneurs' relief on, for example, hotels used in a hotel trade, plant used in a plant hire business and assets leased under a leasing business.

### The calculation of the relief

Where the relief is available, the relevant gains arising on the disposal are aggregated and any losses arising on the disposals are deducted. The resulting amount is reduced by four ninths and that reduced sum is treated for the purposes of capital gains tax as a chargeable gain accruing at the time of the actual disposal by reference to which this deemed gain is calculated. It is then provided that the actual gain and losses taken into account in computing this amount are not chargeable gains or allowable losses as the case may be.

### A welcome addition

This is an outline of the bare bones of the relief. There is much else to be considered. Special provisions deal with exchanges within s 127, qualifying corporate bonds, enterprise investment scheme investments and venture capital trusts. The application of the relief to married couples poses particular problems as does the interaction of entrepreneurs' relief with other capital gains tax reliefs. These are subjects that will no doubt be covered in *Taxation* in future.

The newly proposed entrepreneurs' relief is perhaps a modest relief. It cannot be worth more than £80,000 in relation to each individual (18% – 10% × £1,000,000). Nonetheless, it is a useful new relief for small businesses and its introduction is a welcome addition to the family of reliefs. ■

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