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The Interaction of Entrepreneurs' Relief with Other Reliefs from Capital Gains Tax

^{LT} Capital gains tax; Entrepreneurs' relief

The interaction of particular reliefs from capital gains tax which reduce or exempt gains with other such reliefs always poses interesting questions. Entrepreneurs' relief is no exception.

In this article I consider the interaction of entrepreneurs' relief with hold-over relief, roll-over relief, enterprise investment scheme deferral relief and incorporation relief.¹

The mechanism by which entrepreneurs' relief is given

First, it is necessary to understand the mechanism by which entrepreneurs' relief is given.

The Sub-section (1) Amount

Under s.169N(1) where a claim for entrepreneurs' relief is made "relevant gains" are to be aggregated, as are "relevant losses". The aggregate relevant losses are then deducted from the aggregate relevant gains to give what we shall call the "Sub-section (1) Amount".

If the qualifying business disposal concerned is a disposal of shares or securities the relevant gains are the gains accruing on the disposal. Otherwise the relevant gains are the gains accruing on the disposal of any relevant business assets comprised in the qualifying business disposal. Similarly, if the qualifying business disposal is a disposal of shares, relevant losses are any losses accruing on the disposal. Otherwise, they are any losses accruing on the disposal of any relevant business assets comprised in the qualifying business disposal. Both the relevant gains and the relevant losses are to be "computed in accordance with the provisions of . . .

¹ All references in this article are to the Taxation of Chargeable Gains Act 1992 unless otherwise stated.

[the Taxation of Chargeable Gains Act 1992]. . . fixing the amount of chargeable gains.” Relevant losses are computed on the assumption that notice has been given to HMRC quantifying the amount of the losses.²

The Sub-section (2) Amount

Sub-section (2) then provides that the resulting amount is to be reduced by four-ninths except that if the Sub-section (1) Amount added to all previous such amounts of the disponer exceeds £1 million, the reduction is capped. It is to be made in respect of only so much (if any) of the Sub-section (1) Amount as, when added to the total of the previous Sub-section (1) Amounts, does not exceed £1 million.³

The amount found in accordance with sub-section (2) we shall call the “Sub-section (2) Amount”.

The charge

The Sub-section (2) Amount is to be treated for the purposes of capital gains tax as a chargeable gain accruing at the time of the disposal to the individual or trustees by whom the claim is made.⁴ Any gain or loss taken into account in calculating the relevant gains and relevant losses is not to be taken into account for capital gains tax purposes as a chargeable gain or an allowable loss.⁵

So the mechanism by which the relief is given is to substitute a deemed gain which accrues at the time of the actual disposal but does not arise on it for the actual gains which would otherwise be chargeable and to provide that the actual gains are not to be taken into account as chargeable gains and the actual losses are not to be taken into account as allowable losses.

Example I

Mr Tremlett has previously claimed entrepreneurs’ relief in respect of Sub-section (1) Amounts of £500,000 in aggregate. He now claims relief in respect of a qualifying disposal of his cider making business on which he made the following gains and losses:

² Section 164N(5) & (6).

³ Sub-section (2).

⁴ Sub-section (4).

⁵ Sub-section (9).

	£000
The Dabinett Orchard	400
The Pignout Orchard	(100)
Goodwill	300
Plant	50

His relevant gains are, therefore, £750,000 (£400,000 + £300,000 + £50,000) and his relevant losses are £100,000. His Sub-section (1) Amount is therefore £650,000 (£750,000 – £100,000). Adding this Sub-section (1) Amount to the aggregate of his previous Sub-section (1) Amounts gives a total of £1,150,000. The reduction under sub-section (2) is restricted to four-ninths of so much of the Sub-section (1) Amount on the disposal as, when added to the aggregate previous Sub-section (1) Amounts, does not exceed £1,000,000. So the relief is calculated on £500,000 (£1,000,000 – £500,000) and the Sub-section (2) Amount is £427,778 (£650,000 – (£500,000 × 4/9)).

So Mr Tremlett is deemed to realise a chargeable gain of £427,778 on the date of his disposal of the cider making business. The actual gains arising on the disposals of the Dabinett Orchard, the goodwill and the plant are not chargeable gains and the loss on the disposal of the Pignout Orchard is not an allowable loss.

Hold-over relief

Where hold-over relief is claimed under s.165 on a disposal of business assets or under s.260 on a disposal on which inheritance tax is charged:

- “ (a) the amount of any chargeable gain which, apart . . . [from the application of hold-over relief to the disposal] . . . would accrue to the transferor on the disposal; and
- (b) the amount of the consideration for which, apart . . . [from the relief] . . . the transferee would be regarded for the purposes of capital gains tax as having acquired the asset

. . . .
shall each be reduced by an amount equal to the held-over gain on the disposal”.⁶

The held-over gain on the disposal is the chargeable gain which would have accrued on that disposal ignoring hold-over relief itself.⁷

⁶ Sections 165(4) and 260(3).

⁷ Sections 165(6) and 260(4).

If a claim is made in respect of the same disposal for both entrepreneurs' relief and hold-over relief, what hold-over relief and what entrepreneurs' relief would be given?

Entrepreneurs' relief

We have seen that the first step in computing the deemed chargeable gain which is substituted for the actual gains by s.169N(4) and (9) is to aggregate the relevant gains. We have also seen that relevant gains are the gains accruing on the actual disposals constituting the qualifying business disposal in respect of which the claim is made "computed in accordance with the provisions of . . . [the Taxation of Chargeable Gains Act 1992] . . . fixing the amount of chargeable gains . . .". Does this mean that the aggregate relevant gains are themselves chargeable gains? That cannot be the case because the provision would then contain a circularity. If "gains" in the definition of "relevant gains" meant chargeable gains, one would have to determine the amount of the chargeable gains in order to determine the relief and one would have to determine the relief in order to determine the chargeable gains. Other capital gains tax reliefs deal with this problem by specifically providing that the relief itself is to be ignored in calculating the chargeable gains by reference to which the relief is computed. We have already seen that this is the method adopted for hold-over relief.⁸

So it is clear that if the relevant gains are "computed in accordance with the provisions of . . . [the Taxation of Chargeable Gains Act 1992] . . . fixing the amount of chargeable gains", then the relevant gains must be gains which are computed at a prior stage of the process which results in determining chargeable gains. It is quite clear, from other parts of the capital gains tax code, that a reference to a gain is not necessarily a reference to a "chargeable gain". For example, s.115 provides that a gain which accrues on a disposal of gilt-edged securities or qualifying corporate bonds "shall not be a chargeable gain". It seems clear, therefore, that the relevant gains which are aggregated under s.169N(1) are gains determined at an antecedent stage to the stage at which one determines whether the gains are chargeable or not. As hold-over relief operates, under s.165(4), by reducing the chargeable gain, the claim for hold-over relief will not affect the amounts by reference to which the deemed chargeable gain brought into charge by s.169N(4) is calculated.

Hold-over relief

Turning to hold-over relief, we have seen that that relief operates by reducing the amount of any chargeable gain which, were it not for the relief, would

⁸ Sections 165(6) and 260(4). In relation to EIS deferral relief see Sch.5B para.1(1)(a).

accrue to the transferor on the disposal. The disposal concerned must be the disposal of an asset referred to in s.165(1) (or in s.260(1)). That is, it must refer to the actual disposal. We have seen that, where entrepreneurs' relief is claimed on a disposal, s.169N(4) treats a freestanding amount (albeit one calculated by reference to the actual gains arising on the disposals in relation to which the claim is made) as a chargeable gain accruing at the time of the actual qualifying business disposal, but it does not deem this gain to accrue "on" the disposal.

The result of that is that, if there is a disposal in relation to which both entrepreneurs' and hold-over relief is claimed, there would be no chargeable gain which, apart from hold-over relief, would accrue to the transferor on the disposal because entrepreneurs' relief has the effect that the gains arising on the actual disposals are not chargeable gains; rather a computed amount which does not arise on any particular disposal is treated as a chargeable gain accruing to the claimant.

So it is not possible to receive both hold-over relief and entrepreneurs' relief in respect of the same disposal. Of course, if hold-over relief were more favourable, it could be substituted for entrepreneurs' relief by the simple expedient of claiming the former and not the latter. It should be noted, however, that a claim for entrepreneurs' relief in relation to a qualifying business disposal consisting of, for example, the disposal of a business has effect in respect of all of the assets comprised in that business. So it is not possible to choose to have entrepreneurs' relief on some of the disposals comprised in the qualifying business disposal and hold-over relief on others.

Returning to the facts in Example 1, Mr Tremlett must choose between claiming entrepreneurs' relief on all of the business assets in the Example or on none of them. He could not, for example, claim entrepreneurs' relief in respect of the goodwill and plant and hold-over relief in respect of the Dabinett Orchard.

HMRC's view of the interaction of entrepreneurs' relief and hold-over relief

What is HMRC's view on this? Their Capital Gains Manual says:

"If the whole of the assets comprised in the 'material disposal' for the purposes of Entrepreneurs' Relief are gifted and the subject of a claim under TCGA192/S165 then no chargeable gain will arise at that time. In consequence there will be no 'relevant gain' for the purposes of TCGA92/S169N (1)—see CG64125—and a claim to Entrepreneurs' Relief would not be appropriate.

If however only part of the assets comprised in the ‘material disposal’ for the purposes of Entrepreneurs’ Relief are gifted and the subject of a claim under TCGA192/S165 then a chargeable gain will remain at that time and a claim to Entrepreneurs’ Relief may be made in respect of the amount of gain that remains chargeable.”⁹

On the face of it, the extract simply does not address the point. The question is not whether or not a claim to entrepreneurs’ relief would “be appropriate” where a hold-over relief claim has been made in respect of the same disposal, but what is the result of making both claims? But the reasons advanced in the extract for HMRC’s view imply that they think that the relevant gains under s.164N are chargeable gains and, therefore, that they will have been reduced by hold-over relief before they are aggregated under s.164N(1).

When there is actual consideration for the disposal which exceeds the sums deductible under s.38, hold-over relief is restricted, with the result that a gain remains in charge after the deduction of the relief.¹⁰ The logic of the position taken in HMRC’s guidance is that entrepreneurs’ relief relieves such a gain although the guidance does not deal with the matter specifically.

Roll-over relief on business assets

Where a person claims roll-over relief on business assets under s.152 he is treated:

“ . . . as if the consideration for the disposal of, or of the interest in, the . . . assets [which were the subject of the disposal] were (if otherwise of a greater amount or value) of such amount as would secure that on the disposal neither a gain nor a loss accrues to him . . .”.

Here, it is the consideration received for the disposal and not the chargeable gain which is reduced and the reduction is calculated so as to ensure that no gain (not, no chargeable gain) arises on the disposal. Because it is the consideration which is reduced and because the reduction is not calculated by reference to the chargeable gain which would otherwise accrue on the disposal, the relevant gains taken into account under s.169N(1) for the purposes of calculating entrepreneurs’ relief will be the gains reduced by the claim for roll-over relief on business assets.

So in effect, roll-over relief on business assets will take priority over a claim for entrepreneurs’ relief.¹¹ Roll-over relief on business assets will normally reduce

⁹ CG64137. It is interesting that the authors of *Revenue Law—Principles and Practice*, 26th edn, (Tottel Publishing, 2008) agree that entrepreneurs’ relief takes priority over hold-over relief but seem to be of the opinion that hold-over relief can be claimed in respect of the Sub-section (2) Amount chargeable under s.164N(4). The grounds of this opinion are not given (para.20.86).

¹⁰ Sections 165(7) and 260(5).

¹¹ The authors of *Revenue Law—Principles and Practice*, 26th edn, (Tottel Publishing, 2008) agree that “roll-over relief . . . applies before entrepreneurs’ relief” (para.20.86).

the gain on the disposal in respect of which it is claimed to nil, in which case entrepreneurs' relief cannot further reduce that gain.

Where, however, only a part of the consideration received on the disposal of the old asset is applied in acquiring the new asset, the gain accruing on the disposal will be equal to the amount of the consideration which is not applied to acquiring the new asset.¹² In that case the gains which remain in charge can form part of the relevant gains which are taken into the computation required for entrepreneurs' relief. It is also possible to receive hold-over relief on the disposal of some of the relevant business assets comprised in a qualifying business disposal in respect of which a claim to entrepreneurs' relief is made.

Examples

To return to our example, if Mr Tremlett had invested the entire proceeds of his disposal of the Dabinett Orchard in assets qualifying for roll-over relief on business assets he could have rolled over the gain on the Dabinett Orchard against his acquisition. In that case, he would be treated for capital gains tax purposes as if the consideration for the disposal of the Dabinett Orchard had been such an amount as did not result in a gain accruing with the result that his relevant gains under s.169N(1) would have been reduced to £350,000 (£300,000 + £50,000) and therefore his Sub-section (1) Amount would have been reduced to £250,000 (£350,000 – £100,000). This Sub-section (1) Amount would then have been reduced by four-ninths giving a Sub-section (2) Amount of £138,889 (£250,000 – (£250,000 × 4/9)).

If we vary the example slightly again, we can illustrate the application of s.153. If Mr Tremlett had not invested the whole of the consideration of the Dabinett Orchard in assets qualifying for roll-over relief but, say, all but £50,000 of it, the roll-over relief on the disposal of the Dabinett Orchard would have been governed by s.153 so that the gain accruing on the disposal would have been £50,000. In that event, the relevant gains for the purposes of s.164N(1) would have been £400,000 (£50,000 + £300,000 + £50,000) and therefore the Sub-section (1) Amount would have been £300,000 (£400,000 – £100,000) and the Sub-section (2) Amount would have been £166,667 (£300,000 – (£300,000 × 4/9)).

HMRC's view of the interaction of entrepreneurs' relief and roll-over relief on business assets

What is HMRC's view of this interaction of the two reliefs? Their Capital Gains Manual says the following:

¹² Section 153.

“If the whole of the gain accruing upon the disposal of the old asset is rolled-over against the acquisition cost of the new asset then no chargeable gain will arise at that time. In consequence there will be no ‘relevant gain’ for the purposes of TCGA92/S169N (1)—see CG64125—and a claim to Entrepreneurs’ Relief would not be appropriate.

If however only part of the gain accruing upon the disposal of the old asset is rolled-over against the acquisition cost of the replacement asset then a chargeable gain will remain at that time and a claim to Entrepreneurs’ Relief may be made in respect of the amount of gain that remains chargeable.”

This is correct as far as it goes, but it does not address the situation where the qualifying business disposal for entrepreneurs’ relief purposes consists of several disposals of chargeable assets and roll-over relief claims are made in relation to some but not all of those disposals.

Enterprise investment scheme deferral relief

Where enterprise investment scheme deferral relief (“EIS deferral relief”) under s.150C and Sch.5B is claimed in respect of a disposal, the relief primarily operates by setting an amount “against a corresponding amount of the original gain”.¹³ The “original gain” is the chargeable gain which would accrue to the claimant on the disposal apart from the operation of EIS relief.¹⁴ If this were the only way in which EIS deferral relief were conferred, entrepreneurs’ relief would exclude EIS deferral relief as it does hold-over relief. That is because, as EIS deferral relief operates by reducing the chargeable gain which would otherwise accrue on the disposal, if both entrepreneurs’ relief and enterprise investment scheme deferral relief were claimed in respect of the same disposal, entrepreneurs’ relief would (were it not for the provision discussed below) result in the enterprise investment scheme deferral relief being reduced to nil. That is because, if no EIS deferral relief were claimed, s.164N(9) would have the effect that no chargeable gains would accrue on the disposal.

Schedule 5B para.1(1) provides that the relief applies if:

“(a) there would (apart from paragraph 2(2)(a) below) be a chargeable gain (‘the original gain’) accruing to an individual (‘the investor’) at any time (‘the accrual time’) on or after 29th November 1994;

¹³ Schedule 5B para.2(1).

¹⁴ Schedule 5B para.1(1)(a).

(b) the gain is one accruing either on the disposal by the investor of any asset or in accordance with section 164F or 164FA, section 169N, paragraphs 4 and 5 below or paragraphs 4 and 5 of Schedule 5C”,

and certain other conditions are met.

So specific relief is given for gains arising under s.164N(4). For that relief the relieved gain is not required to arise on a disposal and operates by reducing the chargeable gain which would otherwise arise.

The relevant gains for entrepreneurs’ relief will not be reduced by EIS deferral relief and therefore entrepreneurs’ relief will take priority over EIS deferral relief. EIS deferral relief, however, will then relieve the gain chargeable under s.164N(4); that is the gain which has had the benefit of entrepreneurs’ relief.¹⁵

These provisions of EIS relief give further support to my conclusions on the interaction of entrepreneurs’ relief and hold-over relief. For, if I were wrong in considering that the gain assessable under s.164N(4) does not arise on actual disposals, there would be no need for Sch.5B(1)(b) to give specific relief for gains under that sub-section; the relief would be available in any event because there would “be a chargeable gain . . . accruing on the disposal by the investor of any asset . . .”.

HMRC’s view of the interaction of entrepreneurs’ relief and enterprise investment scheme deferral relief

HMRC’s view of the interaction of the two reliefs, however, is as follows:

“Where a gain arises and Entrepreneurs’ Relief is claimed it is possible that a claim may also be made under a provision which postpones or defers the CGT charged until the occurrence of a future event, such as EIS deferral relief under TCGA92/SCH5B In these circumstances the amount of the postponed or deferred gain is the gain after any Entrepreneurs’ Relief is given.

Where the postponement or deferral provision limits the gains attracting that relief to the lesser of the:

- chargeable gain arising upon the disposal of the ‘old asset’, or
- the consideration applied on the acquisition of the new asset,

then the chargeable gain applicable for the purpose of the first bullet, where a valid claim to Entrepreneurs’ Relief is made, is the ‘chargeable gain’ after the 4/9th Entrepreneurs’ Relief reduction has been made.”¹⁶

¹⁵ The authors of *Revenue Law—Principles and Practice*, 26th edn, (Tottel Publishing, 2008) agree that “EIS deferral relief . . . applies after entrepreneurs’ relief” (para.20.86).

¹⁶ CG64135.

So HMRC's position seems to be that where claims to both reliefs are made in respect of the same disposal, entrepreneurs' relief will be given first and EIS deferral relief will then reduce the gain after entrepreneurs' relief, it therefore agrees with the analysis given above.

Incorporation relief

Where a business is transferred to a company as a going concern in exchange for shares (the "New Assets"), incorporation relief under s.162 may be claimed.

In that case, an amount determined under s.162(4) (the "Section 162(4) Amount") is deducted from the aggregate of the chargeable gains less allowable losses arising on the disposals of the assets comprised in the business (the "Old Assets").¹⁷ This aggregate is called "the Amount of the Gain on the Old Assets". The sums allowed as a deduction under s.38(1)(a) in respect of the New Assets are also reduced by the amount.¹⁸

The Section 162(4) Amount is found by applying a fraction to the Amount of the Gain on the Old Assets. If the result exceeds the cost of the New Assets, the amount is restricted to that cost.¹⁹

It can be seen, therefore, that the starting point of the computation of the amount of relief is the aggregate of the chargeable gains less allowable losses arising on the disposals of the Old Assets. Similarly to hold-over relief, therefore, because incorporation relief is calculated by reference to the chargeable gains which arise on the actual disposals of the assets comprised within the business, where entrepreneurs' relief is also claimed, the amount of those chargeable gains and therefore of the Section 162(4) Amount will be nil. As we have seen, that is because s.164N(9) provides that the gains on the actual disposals are not to be chargeable gains.

Once again, if incorporation relief is more favourable than entrepreneurs' relief, incorporation relief can be substituted for entrepreneurs' relief by the simple expedient of not claiming entrepreneurs' relief.²⁰

HMRC's view of the interaction of entrepreneurs' relief and incorporation relief

Strangely, unlike the other reliefs considered in this article, the Capital Gains Tax Manual does not give HMRC's view of how incorporation relief interacts with

¹⁷ Section 162(2).

¹⁸ Section 162(3).

¹⁹ Section 162(4).

²⁰ Incorporation relief under s.162, of course, applies automatically and does not have to be claimed although it is possible to disclaim the relief under s.162A.

entrepreneurs' relief. I understand, however, that, in correspondence, HMRC have advanced the view that incorporation relief under s.162 "takes precedence" over entrepreneurs' relief.²¹ The correspondence suggests that the grounds of this view are that relevant gains for entrepreneurs' relief purposes are chargeable gains. As we have seen, however, regarding "relevant gains" as being themselves chargeable gains is inconsistent both with the mechanics of s.164N and with Sch.5B para.1(1)(b).

A summary of how entrepreneurs' relief interacts with the other capital gains tax reliefs

Relief	Effect of statutory provisions	HMRC's view
Hold-over relief	Entrepreneurs' relief excludes hold-over relief if both are claimed.	Hold-over relief takes priority over entrepreneurs' relief. It would appear to be a logical consequence of this view that entrepreneurs' relief can reduce the gain after hold-over relief if hold-over relief is restricted under s.165(7) or s.260(5).
Roll-over relief on business assets	Roll-over relief on business assets takes priority over entrepreneurs' relief. If roll-over relief does not reduce the gain on the disposal to nil, entrepreneurs' relief will apply if both reliefs are claimed.	Roll-over relief on business assets takes priority over entrepreneurs' relief. If roll-over relief does not reduce the gain on the disposal to nil, entrepreneurs' relief will apply if both reliefs are claimed.

²¹ The authors of *Revenue Law—Principles and Practice*, 26th edn, (Tottel Publishing, 2008) appear to agree with HMRC's position but do not give their grounds for doing so (para.20.86).

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Enterprise investment scheme deferral relief	Entrepreneurs' relief takes priority over EIS deferral relief, but the gain chargeable under s.169(4) may be relieved by EIS deferral relief if both reliefs are claimed.	Entrepreneurs' relief takes priority over EIS deferral relief, but the gain chargeable under s.169(4) may be relieved by EIS deferral relief if both reliefs are claimed.
Incorporation relief	Entrepreneurs' relief excludes incorporation relief if incorporation relief applies and entrepreneurs' relief is claimed.	Incorporation relief "takes precedence" over entrepreneurs' relief.