

## Clause 1: Entrepreneurs' relief

### Summary

1. This clause and Schedule introduce various amendments to the rules for entrepreneurs' relief (ER). These are:
  - Increasing the period of time during which specified conditions must be met in order for ER to be available when assets are disposed of. The period will increase from one year to two years.
  - Introducing two new tests into the definition of a claimant's 'personal company' which applies for ER purposes. Both of the new tests must be met, along with the existing two tests, throughout the specified period in order for relief to be due. The new tests require the claimant to have (as a minimum) 5% interests in the company's distributable profits and in the assets available to equity holders on a winding-up.
  - Enabling individuals whose shareholding is 'diluted' below the 5% qualifying threshold for entrepreneurs' relief as a result of a new share issue to obtain relief for chargeable gains on the shares up to that time.

### Details of the clause and Schedule

2. Clause 1 introduces Schedule 1, which contains provisions amending Part 5 of the Taxation of Chargeable Gains Act (TCGA) 1992.

### Details of the Schedule

3. Paragraph 1 extends the period through which certain conditions must be met to qualify for ER from one year to two years.
4. Paragraph 1(1) introduces amendments to TCGA 1992.
5. Paragraphs 1(2) to 1(6) change references to one year to two years in various provisions in Part 5 of TCGA1992. These are:
  - Section 169I(3), which specifies the period, ending with the disposal, for which a business must have been owned by the claimant.
  - Section 169I(4)(a), which specifies the period for which a business must have been owned by the claimant where that business has ceased before the disposal.
  - Section 169I(6), which specifies the period, ending with a disposal of

shares, for which the company in question must have been the claimant's personal company and his or her employer, as well as a being a trading company or the holding company of a trading group.

- Section 169I(7), which specifies the period for which the conditions in subsection (6) must have been met where the company ceased to be a trading company before the disposal of its shares.
  - Section 169I(7A)(b), which specifies how long before a disposal of enterprise management incentive (EMI) shares the grant of the option to acquire them must have taken place.
  - Section 169I(7A)(c), which specifies the period, ending with a disposal of EMI shares, for which the company must have been the claimant's employer, and a trading company or the holding company of a trading group.
  - Section 169I(7B)(b), which specifies how long before a company ceased to be a trading company or the holding company of a trading group the grant of an option to acquire EMI shares must have taken place.
  - Section 169I(7B)(c), which specifies the period for which the conditions in subsection (7A) must have been met where the company ceased to be a trading company before the disposal of its EMI shares.
  - Section 169J(4), which specifies the period, ending with a disposal of shares by trustees of a settlement, for which the company in question must have been the qualifying beneficiary's personal company and his or her employer, as well as a trading company or the holding company of a trading group.
  - Section 169J(5)(a), which specifies the period for which assets must have been used in a business carried on by a qualifying beneficiary where trustees of a settlement dispose of those assets.
  - Section 169K(4), which specifies the period for which an asset must have been used in a business for its disposal to be associated with a relevant material disposal.
  - Section 169O(6), which specifies the period by reference to which the 'material time' is determined for the purposes of computing ER due to trustees when their settlement has more than one beneficiary.
  - Paragraph 25 of Schedule 7ZA TCGA 1992, which defines the 'relevant period' for the purposes of Schedule 7ZA.
6. Paragraph 1(2)(d) also inserts new subsections (7ZA) and (7ZB) into section 169I. These allow a period immediately before a transfer of a business to a company to

which section 162 applies, throughout which the business was owned by the claimant, to be treated as if the conditions in subsections 6(a) and (b) of section 169I are met.

7. Paragraph 2 introduces two new tests into the definition of a claimant's 'personal company' which applies for ER purposes. The new tests require the claimant to have (as a minimum) 5% interests in the company's distributable profits and in the assets available to equity holders on a winding-up.
8. Paragraph 2(1) introduces amendments to TCGA 1992.
9. Paragraph 2(2) inserts the two new tests into section 169K(1B), so that the conditions for entrepreneurs' relief on an associated disposal are consistent with the new extended definition of the claimant's 'personal company'.
10. Paragraph 2(3) amends section 169LA TCGA 1992. New section 169LA(1) adds the two new tests to the existing shareholding and voting rights tests which, if any are met, will disallow relief on business goodwill. Note that, as before, only one of the tests must be met in order for relief not to be due. Subparagraph (3)(b) makes a consequential amendment to section 169LA(1A) and subparagraph (3)(c) introduces a definition of a 'relevant group company' into section 169LA(8) for the purposes of new section 169LA(1).
11. Paragraph 2(4) amends section 169S TCGA 1992. New subsection (3) of section 169S contains the extended definition of a 'personal company'. The test requiring a 5% holding of ordinary share capital in the company is retained. The two new tests must be met by virtue of the claimant's holding of ordinary share capital (as well as the existing test requiring 5% of the voting rights in the company). The new tests are written in terms of amounts available to equity holders in the company, and not just to holders of shares.
12. Paragraph 2(4)(b) makes a consequential change to section 169S(4) to ensure the new tests operate correctly where the claimant is a joint owner of shares.
13. Paragraph 2(4)(c) inserts new subsection (4ZA), which imports the definition of an equity holder, along with other terms, from the Corporation Tax Act (CTA) 2010.
14. Paragraph 3 amends Part 5 of Taxation of Chargeable Gains Act (TCGA) 1992 to include a new Chapter 3A.

## Chapter 3A

15. New Chapter 3A contains new sections 169SB to 169SH which allow two elections. The first to determine the gain on the equity holding at the time of the dilution, and the second to defer the accrual of the gain until a subsequent disposal of shares or securities.
16. New section 169SB provides an overview of the chapter.
17. New section 169SC allows an individual to make an election to 'crystallise' a gain by deeming a disposal and acquisition of their shares or securities at market value.
18. New sections 169SC (1) to (3) set out the criteria which must be met for an election to be made. These are:

- The individual's shareholding falls below the 5% threshold required to meet the 'personal company' requirement in section 169S, as a result of a relevant share issue. New section 169SC(5) defines a 'relevant share issue' as an issue of shares by the company wholly for cash and for genuine commercial reasons, and,
  - If a disposal of those shares or securities had been made immediately before the relevant share issue it would have resulted in a gain, which would have qualified for entrepreneurs' relief.
19. New section 169SC(4) gives the effect of the election, which is to deem a disposal and reacquisition of the shares or securities at their relevant value immediately before the relevant share issue. New section 169SC(5) defines 'relevant value' as the amount shares would be sold for if the whole company was acquired at market value, or for other assets, the market value of those assets.
  20. New sections 169SC (5) to (7) provides various definitions for the purposes of the section and chapter.
  21. New section 169SD allows the individual to make a further election to defer the gain which accrued under new section 169SC.
  22. New section 169SD(1) allows an election to be made so that the gain which arose under new section 169SC(4) does not accrue until an actual disposal of the shares or securities.
  23. New section 169SD(2) sets out the rules for calculating the amount of deferred gain that accrues on the later disposal. This is done in three steps.
  24. Step 1 is to attribute the deferred gain between each class of shares or security which were the subject of the deemed disposal. Example: X made an election under section 169SC to defer her deemed gain of £100,000. £25,000 of that gain related to her 50 class A shares and £75,000 of it related to her 50 class B shares. Step 1 allocates the gain between those shares accordingly.
  25. Step 2 is to apportion the amounts identified under step 1 by reference to the nominal value of the shares or securities which were the subject of the deemed disposal that have actually been disposed of. Example: if X sold 25 of her 50 £1 class A shares, the calculation would be £25,000 (the amount of deemed gain attributed to 50 class A shares above)  $\times$  ( $\frac{£25}{£50}$ ) = £12,500.
  26. Step 3 provides that the of the gain that is treated as accruing is the total of all amounts under step 2, but (including any previous disposals) capped at the total amount of deferred gain attributed to that class of shares or securities.
  27. New section 169SD(3) provides that where the subsequent disposal of shares is a capital distribution under section 122 TCGA 1992, then the amount of shares treated as disposed of under Step 2 of new subsection (2) will be the total amount of that class of shares or securities that was the subject of the deemed disposal.
  28. New section 169SE provides rules for where there is a reorganisation of share capital following elections under sections 169SC and 169SD, and the new holding consists

wholly or in part of qualifying corporate bonds (QCBs), such that section 116 TCGA 1992 applies. A chargeable gain is calculated at the time of the reorganisation, but is only treated as accruing when the QCBs are disposed of.

29. New section 169SF provides rules for establishing how much of the deferred gain accrues on a disposal of shares or securities where there has been a reorganisation of share capital under Chapter 2 Part 4 TCGA 1992 after the deemed disposal. The new holding is equated to the original shares using the same apportionment methods as those used to apportion the acquisition costs of the holdings as per Chapter 2 Part 4 of TCGA 1992.
30. New section 169SG sets out the rules for making elections under new sections 169SC and 169SD. New section 169SG(1) ensures that both elections are irrevocable. New section 169SG(2) gives the time limit for an election under new section 169SC as one year after the 31 January following the year in which the deemed disposal takes place, and new section 169SG(3) gives the time limit for an election under new section 169SD as four years after that tax year. New section 169SG(4) ensures that where an individual makes both elections and has no other reason to submit a tax return for the year, they can make both elections by writing to HM Revenue and Customs (HMRC) within one year after the 31 January following the tax year.
31. New section 169SH ensures that entrepreneurs' relief can be claimed on any deferred gain which accrues on a later disposal following an election under new section 169SD, and sets out the rules for making such claims.
32. Paragraph 4 contains the commencement provisions for the Schedule. Paragraphs 4(1) to 4(3) provide that the amendments made by Paragraph 1 have effect for disposals on or after 6 April 2019, except where a business ceased before 29 October 2018. Where the claimant's business ceased, or their personal company ceased to be a trading company (or the holding company of a trading group), before 29 October 2018, the existing one year qualifying period will continue to apply. Paragraph 4(4) provides that paragraph 2 has effect for disposals on or after 29 October 2018. Paragraph 4(5) provides that paragraph 3 has effect for disposals on or after 6 April 2019.

## Background note

33. Entrepreneurs' relief was introduced in 2008 to support business investment and growth of new enterprises. Claimants include self-employed small business owners and individuals who own substantial stakes in limited companies which employ them.
34. This clause and Schedule improve the effectiveness of ER by requiring claimants to have an interest in their business for a longer period of time, and ensuring that claimants disposing of shares had a minimum economic stake in the company. The government considers longer-term involvement and entitlement to share in the profits and assets of a company to be more characteristic of entrepreneurial activity.
35. Changes allowing ER to be claimed on gains made prior to an individual's shareholding being 'diluted' below the 5% threshold in certain circumstances have

been introduced as part of the government's response to the Patient Capital Review. This clause and Schedule act to remove a perceived barrier to growth by allowing these individuals to treat their shareholding as having been disposed of and reacquired at market value at the time of dilution. It also allows them to defer the gain that results from this until the shares are actually disposed of, thus avoiding a 'dry' tax charge.

36. This is in line with the government's policy of supporting enterprise creation and growth in the UK.