



Capital gains tax: allowing entrepreneurs' relief on deferred gains

Who is likely to be affected?

Individuals who defer gains eligible for capital gains tax entrepreneurs' relief (ER) into investments which qualify for the enterprise investment scheme (EIS), or who claim social investment tax relief (SITR).

General description of the measure

ER provides for a lower rate of capital gains tax (10 per cent) to be paid when disposing of all or part of a business where certain criteria are met. The measure will allow gains which are eligible for ER, but which are instead deferred into investments which qualify for EIS or SITR, to benefit from ER when the gain is realised (for instance on the disposal of the EIS shares or the SITR investment), subject to the normal conditions for ER applicable at the time of the original disposal.

Policy objective

This measure is likely to encourage more investment in businesses via EIS and SITR by allowing potential investors to benefit both from the deferral of gains which are reinvested under EIS or SITR and from ER on those same gains. It thereby supports the growth of social enterprises, start-up companies and small and medium sized businesses carried on by companies.

Background to the measure

This measure was announced at Autumn Statement 2014.

Detailed proposal

Operative date

This measure will have effect for disposals of assets which give rise to gains potentially eligible for ER on or after 3 December 2014.

Current law

Chapter 3 of Part 5, and Schedule 5B of the Taxation of Chargeable Gains Act (TCGA) 1992 contain the rules for ER.

Proposed revisions

Legislation will be introduced in Finance Bill 2015 to amend TCGA by inserting new chapter 4 (containing sections 169T – 169V) into Part 5 in order to allow a person to claim ER on gains which have been deferred (held-over) under either EIS or the SITR rules when those gains or any part of them eventually become chargeable.

Summary of impacts

Exchequer impact (£m)	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
	nil	nil	-5	-5	-5	-5
	These figures are set out in Table 2.1 of Autumn Statement 2014 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Autumn Statement 2014.					
Economic impact	The measure is not expected to have a significant economic impact.					
Impact on individuals, households and families	<p>The measure is not expected to impact adversely on individuals or households because it allows a relief to be claimed, at the discretion of individuals, in circumstances where it was not previously available. The information required to support a claim under this measure will be the same as would be required were a claim admissible at present.</p> <p>The measure is not expected to impact on family formation, stability or breakdown.</p>					
Equalities impacts	The measure is not expected to have a significant impact on those with legally protected characteristics. Those affected will broadly reflect the composition of ER claimants.					
Impact on business including civil society organisations	<p>This measure is expected to have a negligible impact on businesses and civil society organisations.</p> <p>The measure is expected to increase the supply of new capital to businesses carried on by limited companies and by social enterprises.</p> <p>It may increase the take-up of shares offered by companies under the EIS scheme.</p> <p>Use of the EIS scheme involves minimal administrative costs for a company. There will be a slight increase in the processing of applications which companies are already undertaking. Based on EIS National Statistics fewer than 500 companies are likely to be affected by the measure.</p> <p>This measure does not impose new types of cost.</p>					
Operational impact (£m) (HMRC or other)	The additional costs and savings for HMRC in implementing this change are anticipated to be negligible.					
Other impacts	<p><u>Small and micro business assessment:</u> small and micro businesses which are carried on by companies are most likely to benefit from this measure as it is expected to increase the availability of new capital to them from investors.</p> <p>Other impacts have been considered and none have been identified.</p>					

Monitoring and evaluation

The measure will be kept under review through communication with affected taxpayer groups.

Further advice

If you have any questions about this change, please contact Rob Clay on 03000 570649 (email: rob.clay@hmrc.gsi.gov.uk).

1 Deferred entrepreneurs' relief on invested gains

- (1) In Part 5 of TCGA 1992 (transfer of business assets) after Chapter 3 (entrepreneurs' relief) insert—

“CHAPTER 4

ENTREPRENEURS' RELIEF WHERE HELD-OVER GAINS BECOME CHARGEABLE

169T Overview of Chapter

This Chapter makes provision about claiming entrepreneurs' relief in certain cases where, in relation to held-over gains that originally arose on a business disposal, there is a chargeable event for the purposes of Schedule 5B or 8B (relief for gains invested under the enterprise investment scheme or in social enterprises).

169U Eligibility conditions for deferred entrepreneurs' relief

- (1) Section 169V applies if, ignoring the operation of section 169V(2)(b), each of the following conditions is met.
- (2) The first condition is that a chargeable gain (“the first eventual gain”) accrues as a result of the operation of—
 - paragraph 4 of Schedule 5B (enterprise investment scheme), or
 - paragraph 5 of Schedule 8B (investments in social enterprises).
- (3) If the first condition is met, the paragraph and Schedule mentioned in subsection (2) that apply in the case are referred to in this section, and section 169V, as “the relevant paragraph” and “the applicable Schedule”.
- (4) The second condition is—
 - (a) that the first eventual gain accrues in a case in which the original gain would, but for the operation of the applicable Schedule, have accrued on a relevant business disposal, or
 - (b) where the first eventual gain accrues in a case in which the original gain would, but for the operation of the applicable Schedule, have accrued as a result of the operation of either of the paragraphs mentioned in subsection (2), that the underlying disposal is a relevant business disposal.
- (5) The third condition is that a claim for entrepreneurs' relief in respect of the first eventual gain is made, on or before the first anniversary of the 31 January following the tax year in which the first eventual gain accrues, by the individual who made the disposal mentioned in subsection (4)(a) or (b).
- (6) The fourth condition is that the first eventual gain is the first gain to accrue in the case as a result of the operation of the relevant paragraph.
- (7) In subsection (4) “the underlying disposal” means the disposal (not being a disposal within paragraph 3 of Schedule 5B or paragraph 6 of Schedule 8B) by virtue of which Schedule 5B or 8B has effect.
- (8) For the purposes of subsection (4), whether the disposal on which the original gain would have accrued is a relevant business disposal, or whether the underlying disposal is a relevant business disposal, is to be

decided according to the law applicable to disposals made at the time the disposal was made.

- (9) In this section –
- “the original gain”, in relation to a particular case, has the same meaning as in the applicable Schedule,
 - “relevant business asset” has the meaning given by section 169L, and
 - “relevant business disposal” means –
 - (a) a disposal –
 - (i) within section 169H(2)(a) or (c) (qualifying business disposals), and
 - (ii) consisting of the disposal of (or of interests in) shares in or securities of a company, or
 - (b) a disposal of relevant business assets which is comprised in a disposal –
 - (i) within section 169H(2)(a) or (c), and
 - (ii) not consisting of the disposal of (or of interests in) shares in or securities of a company.

169V Operation of deferred entrepreneurs’ relief

- (1) Where this section applies, the following rules have effect.
- (2) The gain mentioned in section 169U(2) (“the first eventual gain”) –
- (a) is treated for ER purposes as the amount resulting from a calculation under section 169N(1) carried out –
 - (i) in respect of a qualifying business disposal made when the first eventual gain accrues, and
 - (ii) because of the claim mentioned in section 169U(5), and
 - (b) except for ER purposes, is not to be taken into account under this Act as a chargeable gain.
- (3) If the first eventual gain is a part only of the original gain in the case concerned, each part of the original gain that subsequently accrues as a chargeable gain as a result of the operation of the relevant paragraph –
- (a) is treated for ER purposes as the amount resulting from a calculation under section 169N(1) carried out –
 - (i) in respect of a qualifying business disposal made when that chargeable gain so accrues, and
 - (ii) because of the claim mentioned in section 169U(5), and
 - (b) except for ER purposes, is not to be taken into account under this Act as a chargeable gain.
- (4) If the disposal mentioned in paragraph (a) or (b) of section 169U(4) is a disposal within section 169H(2)(c) (qualifying business disposal: disposal associated with a relevant material disposal) –
- (a) a disposal mentioned in subsection (2) or (3) of this section is treated for the purposes of section 169P(1) as a disposal associated with a relevant material disposal, but
 - (b) section 169P applies in relation to that disposal as if the disposal referred to in section 169P(4) were the disposal mentioned in section 169U(4)(a) or (b).

- (5) In this section “ER purposes” means the purposes of –
 - (a) section 169N(2) to (4B), (7) and (8), and
 - (b) section 169P.”
- (2) The amendment made by subsection (1) has effect in relation to cases where the disposal mentioned in the new section 169U(4)(a) or (b) is made on or after 3 December 2014.

EXPLANATORY NOTE

DEFERRED ENTREPRENEURS' RELIEF ON INVESTED GAINS

SUMMARY

1. Clause [X] extends the scope of capital gain tax entrepreneurs' relief. At the moment a chargeable gain which is deferred either under the enterprise investment scheme (EIS) or under social investment tax relief (SITR) cannot also be the subject of a claim to ER. As a result of these changes, ER may be claimed on deferred gains when they are charged to tax, subject to the conditions for relief which applied when they were first deferred. The new rules apply to gains which would originally have accrued on or after 3 December 2014.

DETAILS OF THE CLAUSE

2. Clause [X] introduces new Chapter 4 (containing sections 169T to 169V) into Part 5 of the Taxation of Chargeable Gains Act 1992 (TCGA 1992) and specifies the date on which they come into effect.
3. Subsection (1) of Clause [X] contains the new sections.
4. New section 169T provides an overview of the new Chapter.
5. New section 169U specifies a number of conditions which must be met in order for a gain which has been deferred under EIS or SITR to qualify for ER when it is treated as accruing. Where all these conditions are met, new section 169V applies to govern how ER is allowed.
6. Subsection (2) of new section 169U states the first condition. A gain representing all or part of a gain which has previously been deferred (or 'held-over') under either EIS or SITR must be treated as accruing under the provisions for those reliefs. The gain which is treated as accruing is known for the purposes of this Clause as 'the first eventual gain'.
7. Subsection (4) of new section 169U states the second condition. This condition specifies the nature of the disposal which originally gave rise to the first eventual gain (before any deferrals). This disposal must be a 'relevant business disposal', as defined at subsection (9). Where a gain has been deferred more than once, for instance by being serially reinvested in more than one holding of EIS shares or social investment, it is the 'underlying disposal' associated with the first deferral which has to meet this condition.
8. Subsection (5) of new section 169U states the third condition. This is that a claim to ER must be made in respect of the first eventual gain. The time limit for this claim is 31 January in the year immediately following the tax year in which the gain accrues. The person making this claim must be the same person who made the disposal which originally gave rise to the first eventual gain.

9. Subsection (6) of new section 169U states the fourth condition. This is that the first eventual gain is the first gain treated as accruing in respect of a particular deferred gain. This means that where part of a deferred gain has previously accrued without a claim to ER being made in respect of it, it is not possible to claim ER under these new provisions when another part of the same gain subsequently accrues.

10. Subsection (7) of new section 169U explains what is meant by ‘underlying disposal’ in subsection (4).

11. Subsection (8) of new section 169U ensures that when deciding whether the ‘source’ disposal identified in subsection (4) was either a material disposal or an associated disposal for ER purposes (see subsection (9)), the law which was relevant to the disposal is to be applied. The ER rules as they stood at any other time, for instance when the first eventual gain is treated as accruing, are not relevant.

12. Subsection (9) of new section 169U provides definitions of terms used earlier in section 169U, including ‘relevant business disposal’ as used in subsection (4). A disposal of shares in or securities of a company is a relevant business disposal if it is either a ‘material disposal of business assets’ or a ‘disposal associated with a relevant material disposal’ (also known as an ‘associated disposal’) for normal ER purposes. A disposal of another sort of asset is a relevant business disposal if it is a disposal of a ‘relevant business asset’ within section 169L and is also either a ‘material disposal of business assets’ or a ‘disposal associated with a relevant material disposal’.

13. New section 169V contains rules which apply where the conditions in section 169U are all met. The rules explain how ER applies to the deferred gain when it is treated as accruing.

14. Subsection (2) of new section 169V treats the first eventual gain as an amount computed under section 169N(1) and therefore as a gain on which ER is due, subject to the ‘lifetime limit’ applicable to the total amount of relief given. However, the gain is not to be treated as a chargeable gain except for ER purposes. That is to say, to the extent that ER is given in respect of it, the first eventual gain is not treated as a gain for other purposes of TCGA 1992. This avoids taxing the same gain twice.

15. Subsection (3) of new section 169V applies where the first eventual gain does not represent the whole of the deferred gain. In these cases, the rest of the deferred gain (when it is finally treated as accruing) is also treated as an amount computed under section 169N(1) on which ER is due, without the need for further claims to ER on the later accrual or accruals. As before, the gains which are subject to ER under this subsection are not treated as gains for other purposes of TCGA 1992.

16. Subsection (4) of new section 169V is relevant when the disposal which was the source of the first eventual gain (see section 169U, subsection (4) above) was a disposal associated with a relevant material disposal (an ‘associated disposal’). It provides that the qualifying business disposal implied by subsection (2) or (3) at the time the first eventual gain accrues is treated as an associated disposal for the purposes of section 169P(1). It also

ensures that when deciding whether section 169P applies, the conditions in section 169P(4) are to be applied to the disposal which was the source of the first eventual gain.

17. Subsection (5) of new section 169V defines the phrase ‘ER purposes’ which is used in subsections (2) and (3).

18. Subsection (2) of Clause [X] gives the effective date for these changes. They apply to gains which have as their source a qualifying business disposal on or after 3 December 2014.

BACKGROUND NOTE

19. The mechanism of entrepreneurs’ relief was amended in 2010. As a result of those changes it was no longer possible for an individual to claim ER on a gain and also to defer the accrual of the same gain if they reinvested the proceeds of their disposal in EIS shares. Nor could ER be claimed when the gain was eventually treated as accruing (for instance when the EIS shares were sold). When SITR was introduced in 2013 the same constraint applied. This has tended to deter investment in EIS shares or in social enterprises in some circumstances.

20. By allowing potential investors to benefit both from the deferral of gains and from ER on those same gains this measure will encourage more investment in business via EIS and SITR. It thereby supports the growth of social enterprises, start-up companies and small and medium-sized businesses carried on by companies.

21. If you have any questions about this change, or comments on the legislation, please contact Rob Clay on 03000 570649 (email: rob.clay@hmrc.gsi.gov.uk).