

Clause 15: Entrepreneurs' relief: company ceasing to be an individual's personal company

Summary

1. This clause enables 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

2. Subsection (1) amends Part 5 of Taxation of Chargeable Gains Act (TCGA) 1992 to include a new Chapter 3A.
3. Subsection (2) contains the commencement provision for this clause. The changes apply to shares held at the time of a new share issue that takes place on or after 6 April 2019.

Chapter 3A

4. New Chapter 3A contains new sections 169SB to 169SF which allow two elections. The first to determine the gain on the shareholding at the time of the dilution, and the second to defer the accrual of the gain until a subsequent disposal of shares or securities.
5. New section 169SB provides an overview of the chapter.
6. 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.
7. New subsections (1) to (3) of new section 169SC 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 subsection (6) 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.
8. New subsection (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.
9. New subsection (5) defines the '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.

10. New subsections (6) to (9) provide various definitions for the purposes of the section and chapter.
11. New section 169SD allows the individual to make a further election to defer the gain which accrued under new section 169SC.
12. New subsection (1) of new section 169SD 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.
13. New subsection (2) sets out the rules for calculating the amount of deferred gain that accrues on the later disposal. This is done in three steps.
14. 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.
15. Step 2 is to apportion the amounts identified under step 1 by reference to how many of the shares which were the subject of the deemed disposal have actually been disposed of. Example: if X sold 25 of her 50 class A shares, the calculation would be £25,000 (the amount of deemed gain attributed to 50 class A shares above) \times $(25 \div 50) = £12,500$.
16. 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.
17. New subsection (3) provides that where the subsequent disposal of shares is a capital distribution under section 122 TCGA, 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.
18. New subsections (4) to (7) provide rules for establishing how much of the deemed gain accrues on a disposal of shares where there has been a reorganisation of share capital under Chapter II Part IV TCGA after the deemed disposal. The new holding is equated to the original shares by reference to the market values of the holdings.
19. New section 169SE sets out the rules for making elections under new sections 169SC and 169SD. New subsection (1) ensures that both elections are irrevocable. New subsection (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 subsection (3) gives the time limit for an election under new section 169SD as four years after that tax year. New subsection (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.
20. New section 169SF 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.

Background note

21. This clause has been introduced following of representations from stakeholders that the 'personal company' requirement for entrepreneurs' relief could sometimes act as a barrier to growth in companies. Currently for a gain on a disposal of shares or securities in a company to qualify for entrepreneurs' relief the claimant must have at least 5% of the voting rights in the company by virtue of holding at least 5% of the ordinary share capital of the company, for a period of one year leading up to the disposal. This may lead to shareholders being unwilling to accept external investment because doing so would 'dilute' their shareholding below the 5% threshold.
22. This clause allows individuals whose shareholding has been 'diluted' below the 5% threshold to retain entrepreneurs' relief on gains which accrue prior to dilution, thus removing the perceived barrier to growth. It does this by allowing them 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.
23. This is part of the government's response to the patient capital review and, and is in line with the government's policy of supporting enterprise and entrepreneurship.
24. If you have any questions about this change, or comments on the legislation, please contact Leah White on 03000 530279 (email: leah.white@hmrc.gsi.gov.uk)

