

Entrepreneurs' Relief on the disposal of shares

"Entrepreneurs' Relief can still offer significant tax savings."

Where available, Entrepreneurs' Relief can reduce the capital gains tax rate to 10% (down from the usual rate of 20%) in respect of the first £1 million of an individual's lifetime qualifying capital gains. It can therefore be a valuable tax relief, offering tax savings of up to £100,000.

When is Entrepreneurs' Relief available?

Entrepreneurs Relief may be available on the disposal of shares (or securities) of a trading company (or the holding company of a trading group) if the seller has, for the two years leading up to the disposal:

- been an officer or employee of the company (or another company within the trading group); and
 - held 5% of the ordinary share capital of the company conferring at least 5% of the voting rights in the company; and
 - either:
 - (a) been beneficially entitled to at least:
 - 5% of the profits available for distribution to equity holders of the company; and
 - 5% of the assets available for distribution to equity holders on a winding up of the company; or
 - (b) been beneficially entitled to at least 5% of the proceeds of sale, in the event of a disposal of the whole of the ordinary share capital of the company
- (the second and third bullets together being "the 5% tests").

In this context, (i) there is no minimum working time requirement for employees or officers; and (ii) non-executive directors and company secretaries, as well as executive directors, count as officers.

An individual's Entrepreneurs' Relief position may need to be considered carefully (particularly given that the conditions detailed above need to be satisfied for the entire two year period prior to the disposal).

The following can affect the availability of the relief:

- other investors having a preferential return on a sale of the company
- shares carrying rights on a sale which vary over time
- the extent to which any earn out becomes payable, or the sale proceeds are effectively reduced, as a result of claims under warranties/indemnities.

Interaction with EMI Options

If the shares being sold were acquired after 5 April 2013 under an EMI option, then the 5% tests are waived. In such cases, the EMI option must have been granted at least two years prior to the date of disposal of the shares. But there is no minimum shareholding, nor any minimum holding period in respect of the shares themselves.



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Other material points to note

Generally speaking, Entrepreneurs' Relief must be claimed on an individual's tax return on or before the first anniversary of the 31 January next following the tax year in which the share disposal occurs. So, for a share disposal in the tax year 2019-20 (ending on 5 April 2020) a claim must be made by 31 January 2022.

The application of Entrepreneurs Relief in the context of certain deferred consideration arrangements, or on a share for share (or share for loan note) exchange, can be complicated. A decision may need to be made as to whether to trigger a "dry" (i.e. when funds are not received) upfront tax charge which benefits from Entrepreneurs' Relief, or to delay crystallising any tax liability but lose the benefit of Entrepreneurs' Relief.

The Enterprise Incentive Scheme (EIS) rules

In some cases, Entrepreneurs' Relief can be available where gains have been deferred under the Enterprise Incentive Scheme (EIS) rules.

Where shareholders are 'diluted' below the 5% tests as a result of commercial issues of shares, elections may be made to claim Entrepreneurs' Relief up to the date of dilution.

Need for advance planning

Given the significant tax savings Entrepreneurs' Relief can offer, it is essential to review entitlement to the relief at the earliest possible opportunity, as there are a number of pitfalls to avoid and the two year holding period requirement means that if the key issues are not considered in good time, this valuable relief can be lost.

Sole traders/partnerships

Entrepreneurs' Relief may also be available in connection with the disposal of the whole or part of a business carried on either by a sole trader or in partnership.