



Share Disposals: Entrepreneurs' Relief and Investors' Relief

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12 March 2019

Entrepreneurs' relief and investors' relief

- / Various changes made in the Finance Act to the legislation governing entrepreneurs' relief (ER)
- / Introduced in FA16 with a minimum three-year qualifying period, the first potential claims to investors' relief (IR) can be made from 6 April (2019)

Entrepreneurs' relief

Familiar rules:

- / Employee or director (shadow director?)
- / In a trading company (high bar definition)
- / Holding 5% of the ordinary share capital (unless acquired by way of the exercise of an EMI option)
- / With 5% of the voting rights by virtue of that holding

ER: old chestnut 1

Trading company

/ Not the 51% test

- A company 'whose activities do not include to a substantial extent activities other than trading activities'
- Excess cash issue

/ The three-year look back 'get out of jail' card

ER: old chestnut 2

Ordinary Share Capital

All issued share capital “other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company’s profits”

- / What about shares with no entitlement to a dividend (or a fixed rate of zero)?
- / Fixed rate preference shares with a token coupon (e.g. 0.00001%)
- / 10% fixed rate preference shares, non-cumulative
- / Cumulative 10% prefs entitled to premium on redemption, sale or liquidation

ER changes

- / Qualifying period
- / Relief for dilution below the qualifying 5% threshold due to cash subscription for shares (i.e. a funding round)
- / Alteration to the 5% test itself

Dilution relief

Two new elections possible:

- (i) Crystallise a notional disposal and re-acquisition on the dilution event (based on a fractional valuation)

Creates a dry charge – eligible for ER – and a step up in the tax base of the shareholding

- (ii) A further election can postpone recognition of the gain arising on the notional disposal until the shares are actually sold

BUT, the second election only deems the 5% rule to be satisfied at that later time; still need to satisfy the other rules for ER (if it still exists) to get the 10% rate on the frozen gain

5% changes to ER

Introduction of economic interest test into 5% rule:

Either

‘that the individual is beneficially entitled to at least 5% of the profits available for distribution to equity holders and, on a winding up, would be beneficially entitled to at least 5% of assets so available’

Or

‘in the event of a disposal of the whole of the ordinary share capital of the company, the individual would be beneficially entitled to at least 5% of the proceeds’

Deeming provision for ratchet mechanisms

Investors' relief

ER : IR : (S)EIS

- / 10% rate on qualifying gains realised after 5 April 2019
- / £10m lifetime cap on qualifying gains – like ER – but standard spousal transfer provisions – unlike ER – so effective £20m allowance for a couple

Investors' relief

Conditions

- (i) Subscription in cash into ordinary share capital
- (ii) From 17 March 2016
- (iii) Trading company (high bar) throughout the period of ownership; but no restrictions on the nature of that trade
- (iv) Can become an unpaid director following subscription (EIS type restrictions) or, after six months, an employee
- (v) Minimum holding period of three years
- (vi) EIS type 'value received' anti avoidance for those three years

Investors' relief

- / Can it be used in conjunction with ER given the permitted director/employee provisions?
- / Why not claim EIS instead, given the subscription requirement?

Investors' relief

ER & IR together

/ Yes! See CG 63560

Non HMRC example

Individual subscribes for 15% of the ordinary share capital of a qualifying company. Becomes a director following subscription

On exit, three years later, anticipated gains of £30m:

/ ER on £10m relating to first 5%

/ IR on £10m relating to second £10m

/ $\frac{1}{3}$ pre-sale transfer to spouse who claims IR on that £10m

Investors' relief

Why not claim EIS instead on previous example?

- / Broad topic requirements for EIS in s.286(3) ITA now runs from ss (za) to (m); that's 21 general areas which can disqualify an investment
- / Excluded activities (includes trades linked to land)
- / Gross asset requirement (£15m)
- / Company age requirement
- / Number of employees test and skilled worker rules
- / Risk to capital requirement; financial health rule