Finance Bill 2018-19: Entrepreneurs' Relief (Clause 15)

Large Corporate | OMB | Personal tax

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The CIOT and ATT have considered FB 2018-19 consultative clause 15 Entrepreneurs' Relief (company ceasing to be individual's personal company, inserting new Chapter 3A in Part 5 TCGA 1992) and some aspects of the consultation response.

Policy approach

The purpose of this new measure is to ensure that Entrepreneurs' Relief (ER) does not act as a barrier to growth for firms seeking additional external investment where the effect of a new share issue 'dilutes' a minority shareholding below the qualifying 5% threshold for relief.

The consultation response says that the government remains open-minded as to whether the risk of losing ER in these circumstances does in fact make an impact on business decisions in significant numbers of companies. The government also attaches importance to the requirement for an election at the point of dilution because it takes account of the fact that knowledge of the loss of ER is playing a role in the company's decision to seek (or not to seek) additional funding.

However, the CIOT is concerned that lack of awareness will mean that the election at the point of dilution will be missed by minority shareholders, particularly in smaller companies that are not receiving advice at the point at which new funding is sought. It seems inequitable that the interests of minority shareholders who are unaware of the loss of ER when new shares are issued should be disadvantaged by the lack of awareness of a measure that would have protected their entitlement to relief had they been aware of it.

The CIOT's proposed solution is to remove the need for elections at the point of dilution. Instead, we suggest that a shareholder should be able to elect, when they dispose of their shares, to treat the appropriate level of gain up to the point of dilution as qualifying for ER. It would not remove the need for a valuation but would go some way to simplifying the process.

Current draft provisions: technical issues

Minority discount

If as a result of external fundraising an individual's shareholding is reduced to below the 5% level, the draft provisions allow that individual to elect for their shareholding to be treated as having been sold at the point of dilution, and immediately reacquired. The price deemed to be paid for the shares on this hypothetical disposal is the market value of those shares as a proportion of the market value of the company as a whole. There is no requirement to discount the price to reflect that it is a minority shareholding. This approach is helpful and one we recommended in the consultation response.

The election can be made if two conditions are fulfilled:

- The first condition (in new section 169SC(2)) is that as a result of the share issue the company ceases to be the individual's personal company.
- The second condition (in section 169SC(3)) is that the hypothetical disposal would have generated a chargeable gain that would have been treated by TCGA 1992 section 169N(2) as accruing to the individual.

However, there is no reference in the draft legislation to a non-discounted valuation when calculating whether or not there is a gain for the purposes of the second condition. CIOT recommended that the same method, that is, ignoring minority discounts should be used to establish whether the second condition is met.

Issue of shares for cash consideration only

New section 169SC(6)(a)) requires that the shares are issued for consideration consisting wholly of cash. Given that the policy intent is to remove a barrier to new investment, consideration might be given to including any form of new consideration, so that in the rare cases where an investment is made in-kind, that

barrier is still removed.

Genuine commercial reasons

New section 169SC(6)(b) provides that shares are subscribed for, and issued, for genuine commercial reasons and not as arrangements the main purpose, or one of the main purposes, of which is to secure a tax advantage to any person.

The reference to genuine commercial reasons would not therefore appear to preclude the election being made on the exercise of tax-advantaged employee share options or by other events, such as a further investment by existing shareholders. Noting the government's response to question 10 in the summary of responses that appears to indicate that the scope is more limited, we requested clarification ideally in the statute itself rather than through guidance.

The CIOT's full submission is on the CIOT website.

The ATT also raised concerns asking for confirmation over how section 169SC(6)(b) is to be interpreted in practice. The ATT's submission is available on the ATT website .