ENTREPRENEUR'S RELIEF – TOO GOOD TO LAST?

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Entrepreneurs' Relief (ER) may be under threat in the budget following the manifesto promise by the Conservatives to 'review and reform' ER.

WHAT IS ENTREPRENEURS' RELIEF?

Introduced by Alistair Darling in 2008, ER was intended to boost UK entrepreneurship by encouraging successful business owners who sell up to reinvest the proceeds into new ventures and growing early stage businesses.

Sadly, there is no proven economic link between ER and business investment, nor with encouraging entrepreneurialism at the outset. And at a cost of £2.2bn last year, the pressure has been on successive Chancellors to examine ER. Speculation about action in the budget has mounted following Boris Johnson's comments that "it is merely making already 'staggeringly rich' people even wealthier".

WHAT IS LIKELY TO HAPPEN?

While it seems unlikely that the idea of rewarding owners and investors for risking their capital will be completely removed, the Government may instead be considering reform of the relief, designed to reduce the tax cost (e.g. by increasing the 10% rate or reducing the £10m lifetime allowance) or ensure that it only applies to individuals more closely aligned with the Government's priorities.

Alternatively, a view which we have not seen mentioned elsewhere but one which we feel could be considered by HMRC, is the introduction of an ER limit per transaction such that ER will have an overriding lifetime allowance but also a lower allowance per transaction. This would encourage serial entrepreneurship rather than a one-off sale of your business and then investing your funds in more conventional means such as stocks and shares. Similarly, serial entrepreneurialism could be encouraged by replacing ER by some form of rollover relief, whereby all or some of the gain may be deferred provided the proceeds are reinvested in business assets. This would serve to keep the cash invested in UK business until the tax is paid on retirement!

Recent reports suggest that the Treasury may be rethinking its plans after concerns that many small business owners have been building up retirement funds within their businesses. The revised plans could see ER closed to new businesses. However, this 'relaxation' may be on a knife edge as new economic data, with lower growth forecast mean the Chancellor may need to find additional savings.

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WHAT CAN YOU DO ABOUT THE PROPOSED CHANGES TO ER?

If you are concerned at these rumours, there are steps you can take to be sure of ER. As with any tax planning however, the tax tail should not wag the dog – and any actions should never come at the expense of a sound commercial strategy.

We have therefore briefly explained some of the options open to you, but before embarking on any of these, we recommend that you speak to your Menzies adviser.

THE SEVEN OPTIONS OPEN TO YOU

1. The first and simplest option would be to bring forward any disposal to before the date of the budget in March. This should ensure that the disposal is subject to the existing tax rules.

2. Alternately, a disposal event could be triggered – for example by selling shares to a new holding company in return for the issue of shares in the holding company. Ordinarily, such a 'share for share exchange' would not be treated as a disposal for tax, however it is possible to elect to disapply this rule, allowing ER to be claimed provided the other criteria are met.
Please note the holding company would need to be inserted for genuine commercial reasons (for example, to protect assets or surplus cash, or ring-fence trading risks) or there is a risk that anti-avoidance rules could apply to deny ER and tax the sale under higher income tax rates.

3. Likewise, and linked to the above, if the share for share treatment has already been applied for a prior transaction, you should consider whether you would like to amend your position such that the share for share provisions are disapplied and ER is claimed now.

4. When considering family companies, all or a percentage of your shares could be settled on a family trust. This would be a disposal for capital gains purposes, ensuring that the gain is charged under existing tax rules and that ER remains available.
Please note that careful planning is required to set up trusts and if you are considering this route you should speak to our specialist trusts team.

5. One thing you should avoid doing however is to defer gains (for example via EIS deferral relief, or holdover relief) that will bring a CGT charge at a later date. This includes gains which do not attract ER as the commonly held view is that CGT rates are at a low and are unlikely to decrease in the future (and indeed could rise).

6. If you are considering liquidating (or winding-up) your company, then it is worth noting that any distributions made by the liquidator will be treated as capital disposals. Depending on the complexity of the company's affairs, it may be possible to bring forward the liquidation forward in order to pay at least an interim dividend out under the current tax rules. Menzies Business Recovery team can advise on the best way forward if this applies to you.

7. Finally, if your shareholding falls below the 5% qualifying threshold required for ER due to the company issuing more shares for cash, you are able to bank any existing entitlement to ER, yet defer paying the resulting CGT until you actually come to sell your shares in the future!

   Please note however, that strict anti-avoidance conditions do apply here and so you should speak to your Menzies contact if you think that it could apply to you.

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