



## Clause 22 and Schedule 2

### Entrepreneurs' Relief (to be re-named Business Asset Disposal Relief)

#### Executive Summary

- **These changes very substantially curtail a relief that had been heavily criticised, reducing the benefit an individual can get over their lifetime from £10m to £1m.**
- **We are disappointed at the absence of formal consultation ahead of this change. We would like to have seen a broad consultation on the relief's objectives and efficacy.**
- **The change has been made very abruptly and with some jagged edges, impacting some innocent commercial arrangements which had largely been put in place on Budget day.**

#### 1 Overview

- 1.1 The effect of clause 22 and schedule 2 is to reduce the lifetime limit for gains qualifying for entrepreneurs' relief from £10m to £1m for qualifying disposals made on or after 11 March 2020. (The relief reduces the effective tax rate on gains which qualify from the normal 20% to 10%.) There are anti-forestalling provisions intended to counter arrangements entered into in anticipation of the Budget that were designed to lock in the higher lifetime limit. Entrepreneurs' relief is to be renamed 'business asset disposal relief' from the tax year 2020/21.
- 1.2 There are no transitional provisions. This is striking as capital gains tax changes are inevitably retroactive, affecting gains that have already accrued but not yet been realised, and investment decisions that have already been made. The draft legislation draws the line; those one side of it have the full benefit of the old £10m limit and those the other side have the new £1m limit.
- 1.3 The line drawn is complicated by what are described as anti-forestalling provisions. There are two sets. In reality these appear to bring under the new £1m lifetime limit some commercial transactions that would not likely have been undertaken in an attempt to forestall this change. Again, it is striking to have strong anti-forestalling measures for what is in essence a change of policy rather than anti-avoidance legislation.
- 1.4 The first anti-forestalling measure applies where an unconditional contract for the sale of a business was entered into before Budget day (11 March 2020) but completion takes place on or after that date. The reduced lifetime limit of £1m, rather than the pre-Budget £10m limit may apply unless conditions, which appear onerous, are met.

There are exceptions to this measure but the conditions to be met are exacting. However, it is our understanding that this provision is intended to counteract arrangements whereby a contract is put in place (maybe before a genuine buyer has been found) to lock-in the pre-

Budget lifetime limit. We understand the conditions for the old, higher limit for relief for these contracts will be met if, for example, the process of entering the contract with a genuine buyer undertaken for commercial reasons was merely accelerated in order to be in place before Budget day.

- 1.5 The second anti-forestalling measure applies where there is an exchange of shares (or a share reorganisation) between 6 April 2019 and 10 March 2020 and a shareholder elects to crystallise the gain on their old shares and pay tax on it (with the benefit of entrepreneurs' relief) rather than defer the gain (as more normally happens with reorganisations and share exchanges) till their new replacement shares are sold at a perhaps much later date - but when they might not be entitled to the relief. This might be because they hold less than 5% of the new shares: holding 5% is a condition of the relief. In certain circumstances, the new lifetime limit of £1m will apply to gains made as a result of such an election rather than the £10m limit in force at the time of the actual exchange or reorganisation if an election had not actually been made by Budget day.

Some taxpayers who have never known or thought about this change in law or tried to forestall it, and who completed commercial reorganisations prior to Budget day will be caught by this change: normally these elections are only filed after the event, with the tax return. This distortion could be largely addressed by a relatively straightforward amendment to the Finance Bill incorporating a simple test of whether the seller qualified for entrepreneurs' relief immediately post exchange. If the seller did not so qualify, the election could still be made post 11 March with the £10m lifetime limit preserved.

Paragraph 3 below expands on who this affects (certain shareholders involved in management buyouts or family successions) and why.

## **2 Open consultation and routine evaluation of reliefs**

- 2.1 Entrepreneurs' relief had been criticised by many including the National Audit Office<sup>1</sup>. There was no formal consultation prior to its introduction (though there was much lobbying at that time) or its subsequent extensions or to its curtailment just now. The government's review of this relief, part of the Conservative manifesto, was conducted internally instead of publicly.
- 2.2 The lifetime limit has previously been increased a number of times<sup>2</sup> since entrepreneurs' relief was introduced in 2008 with an original limit of £1 million. These have been 'surprise' Budget announcements without consultation and no 'roadmap' to provide an idea of the government's thinking or the likely direction of travel.
- 2.2 We would have preferred a broader public consultation about the objectives and efficacy of entrepreneurs' relief to examine the economic rationale and coherence of other aspects beyond the lifetime cap, such as the five per cent ownership condition (where the sale is of a company), the two-year ownership requirement, and more widely the overall policy intent and whether alternative means of meeting it might have been more appropriate.

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<sup>1</sup> <https://www.nao.org.uk/wp-content/uploads/2020/02/The-management-of-tax-expenditure.pdf>

<sup>2</sup> Dates of disposal and lifetime caps: 6 April 2008–5 April 2010 - £1,000,000 6 April 2010–22 June 2010 - £2,000,000 23 June 2010–5 April 2011 - £5,000,000 6 April 2011 – 11 March 2020 - £10,000,000 From 11 March 2020 - £1,000,000

- 2.3 The government's 'Tax Consultation Framework' commits to five stages of policy development and implementation of tax policy. Stage 5 involves reviewing and evaluating the change recognising that monitoring and evaluating tax policy is critical to maintaining the efficacy and productiveness of the tax system. The 2017 Better Budgets report – produced by CIOT in partnership with the Institute for Government and the Institute for Fiscal Studies – called on the government to institutionalise evaluation of tax measures – that is provide for systematic post-legislative review of whether measures are achieving their objectives at an acceptable cost, with Parliament holding government to account.
- 2.4 One difficulty for taxpayers who have legitimately taken advantage of reliefs is uncertainty about when the rules for a particular relief might change. There will be people affected by this change who have reinvested money in the expectation of a relief that they will no longer receive. Such 'retroactive' effects are inevitable in a capital gains tax system. A transparent process of evaluation, conducted as an open consultation or public call for evidence, would have allowed taxpayers some indication of the direction of travel as a background to their investment decisions and reasonable expectations in the lead up to the Budget.

### **3 The anti-forestalling provision potentially affecting management buyouts by key employees and family successions.**

#### **3.1 *Who is affected?***

We have identified two categories that may be adversely affected by the exchange of shares anti-forestalling measure in ways that appear contrary to wider government policy.

- One category concerns a management buyout where shares have been previously granted to key employees who then buy out the founder shareholder(s). The original shareholders may retain a small minority interest (that does not qualify for entrepreneurs' relief) as part of their reduced participation in the business.
- The second is family successions where members of the senior generation step back but again may retain a small minority interest as part of their reduced participation in the business.

In both cases where, immediately after the share exchange, the shareholder's minority holding no longer qualifies for entrepreneurs' relief (or they have fully disposed of their shares) it is very likely they would have made an election, irrespective of the change in lifetime limit, albeit the election would not have been made until the completion of the 2019/20 tax return in accordance with usual practice. The loss of the £10m lifetime limit when an election is made on/after 11 March is solely due to the curtailing of the normal time limit in which an election would usually be made.

#### **3.2 *How does the anti-forestalling provision work?***

Where an exchange of shares (or reorganisation) takes place, the shares issued by the acquiring company are treated as being the same as the shares in the original company, and as acquired at the same time, so that the disposal of the shares at the exchange is not treated as a 'real' disposal for capital gains tax purposes.

That treatment is usually beneficial because CGT is only chargeable on the gain when the shareholder subsequently sells the shares (and proceeds are received) rather than at the time of the exchange or reorganisation when there are no sale proceeds to meet the CGT liability. However, in some cases this treatment is not beneficial because a subsequent sale of shares in the successor company does not qualify for entrepreneurs' relief (perhaps because the shareholder post exchange now holds less than a 5% holding or they are no longer an employee or officer of that company).

In that case, in the normal course of events, the shareholder can elect to crystallise the gain and claim entrepreneurs' relief. For an exchange in 2019/20, that election would normally be made in the 2019/20 tax return to be submitted by 31 January 2021.

In order to prevent the use of the election after Budget day solely to secure the higher £10m lifetime limit, the anti-forestalling provision has the effect that, in some cases, an election made after 11 March crystallises the gain but with the benefit of the £1m lifetime limit only, not the £10m limit that applied at the time of the exchange.

The practical difficulty for shareholders in this position is that usual practice is to make the election at the same time as completing the tax return after the end of the tax year, in this case, the 2019/20 tax return. Consequently, at Budget day, taxpayers would not reasonably have expected to have yet made an election because they would have waited until making the 2019/20 return - due by 31 January 2021.

### 3.3 ***What could be changed?***

An amendment to the anti-forestalling provisions to allow a shareholder, whose shareholding no longer qualifies for entrepreneurs' relief immediately after the exchange, to make an election and retain the £10m limit would seem straightforward. It is demonstrably consistent with the intent of the anti-forestalling provisions to ensure that the election is not used solely to secure the higher lifetime limit. A simple statutory test might be that of whether the seller qualified for entrepreneurs' relief immediately after the transaction.

- 3.4 In cases where a minority shareholding immediately post exchange still qualifies for entrepreneurs' relief but might not do so later for reasons outside their control perhaps because of ill-health forcing retirement, the shareholding being diluted by further share issues to employees or the company ceasing to trade (possibly because of the current crisis), it is likely that an election in the extended period would similarly have been made regardless of the change in the lifetime limit. In this case we recognise that the motive for making the election is more challenging to test and formulate than in respect of a non-qualifying holding. A 'rough and ready' statutory test might be based on conditions that the new holding is below 10% and that it had been reduced by at least a half compared to the old stake in the target company.

## 4 **The Chartered Institute of Taxation**

- 4.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers

and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation  
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