

ENTREPRENEURS' RELIEF (ER) – PRACTICAL POINTS

Guide for members on technical points raised with HMRC

This guide has been agreed by HMRC and came out of discussion and correspondence with the ER Sub-Group of the Capital Gains Tax Liaison Group (an HMRC led group involving the CIOT, ATT and other tax professional bodies and others with a key interest in Capital Gains Tax).

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Introduction

- 1 A number of technical points have been raised with HMRC on the operation of ER, through the Capital Gains Tax Liaison Group and then the ER sub-group.
- 2 The sections below are a result of this dialogue. We are grateful to HMRC for its assistance and for allowing us to make its responses public. This is done, however, with the following caveats:
 - while indicating the HMRC view of how the provisions interact, the responses are based on the terms of the queries; and
 - in actual cases it may also be necessary to take into account general HMRC guidance on the website.
- 3 All references are to TCGA 1992 unless otherwise noted.
- 4 Our discussions on ER continue and further queries have been put to HMRC. We will update this guide as further answers are received. It is expected that the HMRC guidance on ER will be updated to cover the issues within this current note (and any further updates).

SECTION A – GENERAL ER QUERIES

EXAMPLE A1 – Aggregation issues: determining the quantum of the qualifying gain (1)

- 5 CG64120 of the HMRC *Capital Gains Manual* deals with the aggregation of qualifying ER gains and losses (as per s 169N, TCGA 1992) made on the disposal of various assets comprising a business. However, the guidance does not consider cases where assets are disposed of in different tax years. How does HMRC consider that the ER provisions should be applied in such cases?
- 6 Does HMRC consider that the aggregation provision could relate to disposals of shares over different tax years?

HMRC response to Example A1

- 7 We have no experience of actual cases which involve a disposal, of the whole or part of a business, which is made up of separate disposals that occur in different tax years. At present HMRC is unwilling to speculate as to how a particular fact pattern might be most appropriately treated.
- 8 As regards shares disposed of over different years, each separate disposal will constitute a separate material disposal for the purposes of s 169I(1) and no aggregation under s 169N(1) is necessary. HMRC is not of the view that aggregation applies to shares and securities of one company that are disposed of in separate transactions.

EXAMPLE A2 – Aggregation issues: determining the quantum of the qualifying gain (2)

- 9 HMRC was asked to comment on the following example and whether it would accept that in this situation the disposal of all the assets of a business would not necessarily constitute one qualifying disposal for ER.
- 10 A lawyer who operated as a sole trader may sell his business to a larger law firm, disposing of all assets apart from the long lease he has on the business premises (the purchaser did not intend to use the premises so did not want to acquire the asset). He might separately manage to negotiate the sale of the lease to another purchaser. The profit on the sale of the aggregate business assets acquired by the large law firm may be £950,000 with a loss of £75,000 on the lease.
- 11 As the two disposals are totally separate we would argue that the loss on the sale of the lease should not be aggregated with the profit on the sale of the business. As such the special 10% ER rate should apply to the whole £950,000 and if the individual had non-ER qualifying gains in the tax year the loss on the sale of the lease could be set against these gains in preference to the qualifying ER gain. Can HMRC confirm that it agrees with this analysis?

HMRC response to Example A2

- 12 The legislation which defines relevant business assets, relevant gains and relevant losses for the purposes of quantifying the amount of relief is s 169N, TCGA 1992. The key issue is whether the disposal of the long lease is comprised in the qualifying business disposal (ie the disposal of the sole trader's business).
- 13 It is difficult to see how the disposal of the long lease in the query is not an inherent part of the disposal of the sole trade business. In particular, HMRC does not consider the fact that the lease is disposed to a third party is sufficient by itself to show that the disposals are 'totally separate' as the query suggests.
- 14 Where someone wishes to assert that the disposal of an asset, such as the long lease in the query, is not comprised in the qualifying business disposal, that point will be a question of fact for which the individual would need to provide a clear explanation and evidence to support their contention.

EXAMPLE A3 – The s 28, TCGA 1992 problem

- 15 Section 28, TCGA 1992 specifies that where an asset is disposed of under an unconditional contract the time when the disposal is deemed to take place is the time the contract is made, not the time the asset is conveyed or transferred.
- 16 For ER purposes, taken literally this can cause a significant problem. Commercially it is not always possible for the trade to cease on or before the date the contract is made, but it is a

condition to qualify for ER that the trade must have ceased before the disposal occurs. This affects both individuals (s 169I(4)) and trustees (s 169J(5)).

HMRC response to Example A3 (January 2010)

- 17 Both s 169I(4) and s 169J(5) contain the condition that the individual or beneficiary ceases to carry on the business on or before the date of disposal of the asset used in that business. However, it is possible that where a business property is sold under a contract the beneficiary continues to use the property to trade from for a period after the date of the contract. Section 28, TCGA 1992 determines that the date of disposal is the date of the contract, so the disposal for CGT purposes happens before the cessation.
- 18 We believe that in such cases, where there is a genuine business disposal linked to a genuine business cessation, ER should not become unavailable where the strict application of s 28 determines the date of disposal to be before the date of cessation.

Further example provided to HMRC for comment

- 19 In connection with a material disposal of business assets, consider a sole trader where a contract for the sale of a shop (from which a retail trade had been carried on) had been concluded on 30 June 2009 with entry on 1 September 2009, and the trade had ceased on 31 July 2009. Does HMRC agree that ER will apply to the disposal of the shop and 'business' (goodwill) as if it were a single disposal?

HMRC response (June 2010)

- 20 Where a business property is sold under a contract and the individual continues to use the property to trade from for a period after the date of the contract, s 28 will determine that the date of disposal is the date of the contract. In this case the disposal for CGT purposes will happen before the cessation. If the facts indicate there is a genuine business disposal linked to a genuine business cessation, ER should not become unavailable where the strict application of s 28 determines the date of disposal to be before the date of cessation.

Query following HMRC's comment on the example put forward

- 21 It is unclear from this response whether HMRC considers that the sale of the property on 30 June 2009 in the example qualifies for ER under s 169I(2)(a) or s 169I(2)(b). Section 169I(4) provides that a disposal within s 169I(2)(b) is a material disposal if the conditions in sub-sections 4(a) and (b) are fulfilled. The disposal of the property falls outside the three year period in s 4(b).
- 22 Does HMRC consider that the disposal of the property on 30 June 2009 therefore falls within s 169I(2)(a)?
- 23 Assuming that is the case, the gains and losses from the two disposals under s 169I(2)(a) comprising the same business would be aggregated in accordance with s 169N with the same potential aggregation issues arising as noted in Example A1 above.

HMRC further response

- 24 The scenario set out was understood to seek comfort in relation to ER in the absence of an Extra-Statutory Concession which was previously available under the old retirement relief legislation. This was given on the basis that there was a genuine linked business disposal. However, were the disposals separated then whether each would fall within s 169I(2)(a) or (b) would of course very much depend upon the facts and compliance with the legislative conditions.

Further note¹

- 25 The HMRC responses through the CGT Liaison group are consistent. However, the ICAEW Tax Faculty received a different response from HMRC when the ICAEW raised a similar question in late 2009 in respect of trustees (as part of the quarterly meeting on IHT and trust tax issues). The response provided then was that ER would be forfeited where trading continues after exchange of contracts when a business is sold by trustees. The issue and this response are in ICAEW's *TAXline* (September 2009, practical point 186).
- 26 The disparity between the responses has been brought to the attention of HMRC and we have been told that the current HMRC settled view is reflected in the responses received through the CGT Liaison Group set out here. It is understood that HMRC does not consider this to be a concession but rather a purposive interpretation of the legislation.

EXAMPLE A4 – Disposal of whole or part of a business

- 27 Consider a farmer who sold four fields (10 acres) in which oilseed rape was grown. This crop was not grown elsewhere on the farm before the sale and is not grown elsewhere after the sale because of soil conditions.
- 28 Does HMRC consider that this sale would amount to a disposal of 'part of the business'?

HMRC response to Example A4

- 29 A number of cases were heard in respect of the old retirement relief as to what the meaning was of the disposal of part of a business. The legislative language for ER mirrors those conditions so HMRC believes the earlier cases are likely to be persuasive for this reason.
- 30 CG64015 onwards discusses a number of these cases and rather than comment on the situation you set out above I would highlight that CG64035 draws together the various points that case law teaches us, it is then in this context, and only with knowledge of all the relevant facts, that a judgement can be made as to whether the disposal constitutes a distinct part of the business or simply of assets sold out of a continuing business.

Further note

- 31 Members should therefore proceed with great caution where there is any suggestion that the disposal taking place might not amount to a part disposal of the business, paying particular attention to the decision in *McGregor v Adcock* and related cases.

EXAMPLE A5 – Interaction with other reliefs – pre 23 June 2010 disposals

- 32 For pre-23 June 2010 disposals there is agreement that ER takes priority over EIS CGT deferral relief and that business asset rollover relief takes priority over ER relief. There are, however, mixed opinions about the order of priority between (1) ER and gift holdover relief (ie both s 165 and s 260 of TCGA 1992) and (2) ER and incorporation relief.
- 33 HMRC's settled view (which is not universally accepted) is that gift holdover relief has priority over ER relief (see CG64137 of the HMRC *Capital Gains Manual*) and that incorporation relief also has priority over ER. HMRC's view on the order of priority between incorporation relief and ER is not explicitly stated.
- 34 When asked to confirm its position HMRC stated its view as follows:

¹ This Guide has also been published by the ICAEW Tax Faculty. The sections headed 'Further note' in this Guide appear as 'Author's note' in the ICAEW 's publication.

‘CG64136 clearly states how ER interacts with rollover reliefs and CG64137 deals similarly with deferral reliefs. Section 162, TCGA 1992 (incorporation relief) is a form of rollover relief and the principle is that ER is only available on any part of a gain that remains after any rollover (or for that matter deferral) has been made.’

EXAMPLE A6 – Qualifying periods of ownership: different rules for individuals and trustees

- 35 The general rule is that for a disposal to qualify for ER the specific conditions applying to the asset category must have been met for a period of at least one year.
- 36 For individuals, depending on the nature of the disposal, the conditions under s 169I must be satisfied in the one-year period ending with the date of disposal or of cessation of the business (provided this date of cessation is within the period of three years ending with the date of the disposal).
- 37 For trustees the relevant timing provision in s 169J(4) is more flexible and may apply for a wider time period. It allows the qualifying period during which the relevant conditions must be satisfied to be a period of one year ending not earlier than three years before the date of the disposal.

HMRC response to Example A6

- 38 The wider time period available to trustees recognises (in broad terms) that trustees may not have the same scope to determine when they dispose of their business assets as the qualifying individual would. We are not aware of any problems arising in practice from the distinction.

EXAMPLE A7 – The 5% rules and dilution on the day of sale

- 39 Consider the following situation (assume that all other conditions for ER are satisfied):
- Shareholder X holds 5% of the ordinary share capital in a company and has done so throughout the period of at least one year up to the date of the sale of the entire share capital of the company.
 - There are holders of share options who intend to exercise their rights and acquire shares on the date of sale shortly before taking part in and signing the contract for sale.
 - The contract for sale is entered into on, say, 12 noon on the day of sale.
 - By virtue of the exercise of the options earlier in the day, at the time of disposal (ie signing of the contract) X will hold less than 5% of the ordinary share capital of the company.
- 40 Does X fail to meet the conditions of s 169I(6)?
- 41 It has been posited that were the day of the sale to be included within the interpretation ‘throughout the period ending with the date of disposal’, it would be impossible for any individual to meet the qualifying criteria for ER, as during the course of that day they would no longer meet the conditions under s 169I(6), ie once the contract for sale had been signed.
- 42 A possible view is that ‘throughout the period ending with the date of disposal’ ends on midnight the day before the sale and therefore excludes the actual day of sale. X would therefore qualify for ER on the basis that he had met the conditions of s 169I(6) at that time.

HMRC response to Example A7

- 43 The direct application of the statute, without need for interpretation of the words of that statute, provides the answer to the query.

- 44 We do not consider that the legislation for ER can be read as making any division of a day on a minute by minute (or second by second?) basis. In particular it does not require an interpretation that the statute must read as 'throughout the period ending with the date of disposal' ends on midnight the day before the sale.
- 45 Assuming that X satisfies all the other conditions for the relief, it is clear that X would not be ineligible from claiming ER on the disposal of his shareholding solely by virtue of the exercise of options earlier in the day on which he disposes of his shares and the exercise of options results in his ownership and voting rights dropping below the critical 5% threshold.

EXAMPLE A8 – Interaction of ER and temporary non-UK residents (s 10A, TCGA 1992)

- 46 An individual owns shares in a UK trading company (which qualify for ER). He moved/located overseas to expand the business.
- 47 The overseas business failed. An offer has been made to acquire his shares. Although the sale should take place when he is non-UK resident there is a possibility that he may be caught by s 10A, as he may return to the UK approximately four years after he left.
- 48 The issue is whether ER will still be available on the chargeable gain.

Technical tax analysis put forward for HMRC comment

- 49 Under s 10A, TCGA 1992 the gain will be treated as accruing to a taxpayer in the year of return. The view taken is that the original disposal date applies for ER purposes. As s 169M requires an election for ER to be made before the first anniversary of 31 January following the tax year in which the disposal takes place, it is likely that the individual will be out of time in making an ER claim if he waits until he has resumed UK residence. The advice is therefore to make a protective claim.
- 50 It would seem that exactly the same principle would apply to a UK-resident foreign domiciliary who is taxed on the remittance basis. A disposal may occur in an early year on which ER would need to be claimed (albeit the gain was not yet taxed on the individual as it was not remitted). However, if the individual remitted the gain several years later, but no protective ER claim had been made for the actual year of disposal, no ER deduction could be made in the computation in this later year.

HMRC response to Example A8

- 51 ER is only available on the making of a claim and such claim must be made within the statutory time limit which is set by reference to the date of the qualifying disposal (see s 169M(3), TCGA 1992). It is for the taxpayer to consider whether to submit a protective claim for ER within this time period.

SECTION B – ORDINARY SHARE CAPITAL AND THE 5% TEST

EXAMPLE B1 – The meaning of ordinary share capital

- 52 In relation to ER, s 169S(5) states:
- 'ordinary share capital' has the same meaning as in the Income Tax Acts [see s 989, ITA 2007].'
- 53 Section 989, Income Tax Act 2007 (ITA 2007) defines 'ordinary share capital':

‘ordinary share capital’, in relation to a company, means all the company’s issued share capital (however described), 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.’

HMRC response to Example B1

- 54 The meaning of ‘issued share capital’ was considered by Megarry J in *Canada Safeway Ltd v IRC* [1973] 1 CH 374 and is authority that it is nominal value that is adopted. Megarry J’s analysis was extensively considered and applied in the more recent Upper Tribunal case of *HMRC Commissioners v 1) Taylor and 2) Haimendorf* [2010] 417 (TCC) at paras 14–18. In particular at para 17, The Hon Mr Justice Roth considers the meaning of the phrase in the context of the legislation:

‘Although the Canada Safeway case was therefore not addressing directly the issue of subscribed value, its reasoning appears to me to apply equally in the present case. Moreover, the expression ‘issued share capital’ is used frequently throughout the ICTA. As the Respondents were constrained to recognise, it would be a striking result if the same form of words were to receive a very different interpretation within the same statute. In my judgement, if that result was intended, the draftsman would have made express provision for this by including a distinct definition of issued share capital specifically for the purpose of this part of the legislation in s 312. In the absence of such special definition, I consider that the phrase must receive the same meaning throughout ICTA. That meaning has been well-established since the Canada Safeway judgement that has been applied for almost 40 years. Accordingly, I consider that it is clear that issued share capital in paragraph (b) refers to the nominal value of the shares. Once that is determined as the correct interpretation, the potential practical difficulty of aggregating the two elements in paragraph (b) falls away; the actual calculation is straightforward.’

Further note

- 55 To conclude, when considering whether the 5% test is met HMRC’s settled view is that one must look to the nominal value of the ordinary shares not to the number of ordinary shares that have been issued.

SECTION C – ASSOCIATED DISPOSALS

EXAMPLE C1 – What constitutes a ‘withdrawal from the business’?

- 56 CG63995 of the *Capital Gains Manual* states that a withdrawal from participation in the business relates to a ‘material disposal of business assets’.
- 57 Section 169K, TCGA 1992 provides that three conditions (conditions A, B and C with condition C relating to the necessary qualifying period) must be met for there to be an associated disposal. A ‘material disposal of business assets’ is condition A and it is only in condition B where the disposal is connected with a withdrawal from the business. Section 169K(5) makes it clear that the disposal referred to in condition B is the associated disposal not the relevant material disposal.
- 58 We would welcome HMRC’s views on the following two points:
- How can the withdrawal from the business relate to both disposals and be caused by the same event?; and
 - HMRC guidance says for a withdrawal from the business to occur it is not necessary to reduce the hours worked. So if the hours worked remain the same what exactly is a withdrawal from the business?

HMRC response to Example C1

- 59 It is a question of fact in each case whether there has been a 'withdrawal from the business'. The issue is not linked to the amount of work done or time spent working in the business, but the material disposal and the associated disposal must together constitute a withdrawal from the business, ie being made as 'part and parcel' of the same event, even if the associated disposal is made sometime after the material disposal (see HMRC guidance at CG63995 and example 2 in CG64000). This view carries over from retirement relief and was confirmed in the case of *Clarke v Mayo* (66 TC 728).

EXAMPLE C2 – How many shares must be disposed of to constitute 'a material disposal'?

- 60 The legislation does not specify the percentage of shares which must be disposed of to make the disposal of shares a material disposal, so does HMRC accept that any drop in shareholding would be a material disposal?

HMRC response to Example C2

- 61 There is no *de minimis* limit for the reduction in shareholding that constitutes a material disposal under s 169I(2)(c).

EXAMPLE C3 – The time between the material disposal and the associated disposal

- 62 The legislation does not give a time limit during which the associated disposal must be made. As such the HMRC guidance at CG63995 of the *Capital Gains Manual* seems to go further than the legislation. It would be helpful to clarify this.

HMRC response to Example C3

- 63 Clearly the question of whether the material disposal and the associated disposal together form part of a wider 'withdrawal from business' depends on the particular facts of each case.
- 64 HMRC's guidance at CG63995 relates to cases where the 'associated' asset has not been used for other purposes and is intended to allow a reasonable application of s 169K in line with the time limit used elsewhere in ER.

Further note

- 65 Readers will be aware that s 169P restricts the amount of ER available on an associated disposal in certain conditions. One of these conditions, s 169P(4)(d), is where during some part of the period when the assets are used for the purposes of the business their availability is dependent on the payment of rent. We understand that HMRC's view is that the condition at s 169P(4)(d) is only met where actual rental income is received by the partner. It is understood that HMRC does not feel that ER should be restricted where there is an arrangement under which a partner receives a higher profit share as a result of letting the partnership use their personal property.
- 66 In connection with associated disposals, HMRC has been asked to confirm that the continuous 12-month holding period only has to be met with respect to the material disposal. The following example has been put to HMRC and we await its response:

'TradeCo Ltd is a trading company owned by Mr W and his wife Mrs W. Each spouse has since incorporation owned 50% of the company and been a director of the company. The property used by the business was acquired solely by Mrs W in 2008. The company has used the property since then and no rent has been paid. In December 2010 half of the property was transferred to Mr W. All the shares in the company and the property were sold to BigTrade Co Plc in June 2011.

'The asset has been used in the business for the qualifying 12- month period as set down in condition C of s 169K. Mr W has not, however, owned the his interest in the property for 12 months.

'Can Mr W claim ER on both his shares and his interest in the property?'

SECTION D – THE REMITTANCE BASIS AND ER

EXAMPLE D1 – Foreign chargeable gains qualifying for ER fall within s 12, TCGA 1992

- 67 Section 169N(9), TCGA 1992 states that 'any gain or loss taken into account under section(1) is not to be taken account under this Act as a chargeable gain or an allowable loss.'
- 68 The Explanatory Notes published with the Finance Bill 2008 indicate that the purpose of s 169N(9) is merely to ensure that where there is one ER disposal, and gains and losses are aggregated to determine the qualifying net ER gain, this cannot be segregated as gains and losses separately for CGT purposes. There have, however, been concerns about the interpretation of s 169N(9) and how it interacts with other provisions within TCGA 1992.
- 69 As can be seen from the responses to the following queries, HMRC considers that foreign chargeable gains qualifying for ER fall within s 12, TCGA 1992 where such gains are realised by remittance basis users. The delay between the time the gains arises and when the remittance is made is no bar on the claiming of ER provided a valid ER claim is made within the specified time period (see Example D2).

EXAMPLE D2 – The deadline for making an ER claim

- 70 The deadline for making an ER claim is linked to the tax year in which the qualifying business disposal is made, not to the tax year that the gain accrues to a taxpayer. Thus if a UK-resident foreign domiciliary wishes to make the claim for a qualifying business disposal of foreign property, it would seem that the following deadlines apply for disposals in the specified tax years, regardless of whether the chargeable gain has been remitted.

Tax year	Claim deadline
2008/09	31 January 2011
2009/10	31 January 2012
2010/11	31 January 2013
2011/12	31 January 2014

- 71 Does HMRC agree? How would it recommend that such a claim be made if it does not impact on the tax liability as there has been no remittance of the disposal proceeds?

HMRC response to Example D2

- 72 ER is only available on the making of a claim and such claim must be made within the statutory time limit which is set by reference to the date of the qualifying disposal (see s 169M(3), TCGA 1992). It is for the taxpayer to consider whether to submit a protective claim for ER within this time period.

Further note

- 73 This means that where a remittance basis user makes a qualifying gain in a tax year he or she has until the first anniversary of 31 January following the end of the tax year to decide

whether or not to make the ER claim. The date that the proceeds are remitted is irrelevant.

- 74 For example: AB is a remittance basis user. He makes a £10m gain on a qualifying disposal in 2011/12 of shares in a foreign company (total proceeds £15m). He has not made any previous ER claims and so has the entire £10m ER allowance available. He does not expect to remit the proceeds from the gain for at least three years (having sufficient clean capital to supplement his UK income). If he wants to be able to benefit from ER on any eventual remittance of the proceeds he has until 31 January 2014 to make the ER claim. The fact that he will not have remitted the proceeds at that date is irrelevant to the claim deadline.
- 75 Where an ER claim is required prior to the gains being remitted there will be no gain shown on the tax return. The claim should be made by way of a note to the tax return, with the ER computation included.

EXAMPLE D3 – The raised ER limit

- 76 It is understood that HMRC's settled view is that the ER limit to apply in respect of remittance basis gains is that which is in force when the gains arise.
- 77 For example, assuming there have been no other qualifying ER gains, where the disposal date for a qualifying ER gain of £5m (paid into a separate offshore bank account with interest being paid into a separate account) is 19 August 2008 and the proceeds are remitted on 25 October 2010, it is understood that HMRC believes that the £1m lifetime limit in force in 2008/09 applies, such that ER can only be claimed on £1m of the disposal. It would seem to follow from this that HMRC's view must be that the 4/9ths deduction applies to the gain rather than the special 10% tax rate. For a higher rate taxpayer this would mean that even the gain benefiting from ER will be subject to tax at 28% (meaning an effective 15.6% tax rate on the £1m gain benefiting from ER relief) with the £4m excess being taxed at 28%.
- 78 Can HMRC confirm that the above summarises its thoughts on the issue?

HMRC response to Example D3

- 79 HMRC agree with the analysis. The ER limit to apply with respect to remittance basis gains is that which is in force when the qualifying disposal is made, not when any proceeds are remitted.

EXAMPLE D4 – The ER provisions prior to 23 June 2010 and the mixed fund rules

- 80 The ER legislation at s 169N(4), TCGA 1992 states:
- ‘The amount arrived at under subsections (1) to (3) is to be treated for the purposes of this Act as a chargeable gain accruing at the time of the disposal to the individual or trustees by whom the claim is made.’
- 81 Does HMRC agree that this means that for the purposes of the mixed fund rules (s 809Q, ITA 2007) the amount that will go into the foreign chargeable gains category is the amount of the gain after ER (ie after the 4/9ths reduction)?

HMRC response to Example D4

- 82 The amount to be included in a mixed fund under s 809Q(4), ITA 2007 is the gain as restricted by s 169N.

EXAMPLE D5 – How does ER relief work for remittance basis users given it is now a tax rate?

- 83 It is clear that without the 4/9ths discount provisions, which reduced the gain itself, the mixed fund rules work somewhat differently. It is unclear whether, in situations where the gain is in excess of the unused ER lifetime allowance, this means that:
- ER can be applied such that 10% tax is paid on the amount on which ER can be claimed (either the £10m lifetime limit or that limit less the aggregate of prior ER claims made) with future remittances being taxed at the full rates.
 - Or, that a blended rate has to be used.
- 84 As an example: the capital gain on a disposal of shares by a UK-resident foreign domiciliary is, say, £13m. The individual has not made a prior ER claim and the first £10m is remitted over a number of years. Can you apply ER to this first £10m or do you have to use a blended rate because the actual gain exceeds £10m?

HMRC response to Example D5

- 85 Wherever there is a qualifying disposal and a chargeable gain that attracts the tax rate of 10% and there is a balance of that gain that is taxable at either 18% or 28% (and indeed where the individual may have other gains that do not qualify for ER), then the question arises of how these elements are identified for the purposes of s 12, TCGA 1992.
- 86 HMRC considers that the mixed fund rules in ITA 2007 may be used to identify and quantify the remittance of the foreign chargeable gain. In the absence of a statutory rule for determining whether or not the gains brought into charge under s 12 are liable at the 10% rate, the onus is on the individual to nominate the 10% rate to apply to the maximum extent (by reference to the computational rules in ss (4)–(4B) of s 169N) in priority to other rates and the individual can do so as part of the normal self assessment process.

Further note

- 87 We have confirmed with HMRC that the above response means that in the example given the taxpayer would be able to claim on his or her self assessment return that the first £10m remitted is taxed at the special 10% rate.
- 88 For example: the disposal occurred in 2011/12 and pattern of remittance was as follows:
- £5m in 2011/12;
£5m in 2012/13; and
£3m in 2013/14.

Provided an ER claim is made the taxpayer can claim that the remittances in 2011/12 and 2012/13 are taxed at the 10% ER rate.

SECTION E – DISPOSAL OF SETTLEMENT ASSETS

EXAMPLE E1 – Trustees and qualifying corporate bonds (QCBs)

- 89 The treatment of trustees appears to be less favourable than that of beneficiaries where QCBs are in point. Section 169R does not appear to apply to trustees, and the trustees cannot use s 169Q to elect to disapply s 127 where the security received is a QCB because s 116(5) says that ss 127–130 shall not apply.
- 90 The transitional rules in para 7, Sch 3, FA 2008 apply to individuals and not to trustees.

HMRC response to Example E1

- 91 The election under s 169Q to disapply the normal 'no disposal' treatment in s 127 for share reorganisations (etc) is available to trustees and individuals. That section is of no relevance to QCBs acquired by either individuals or trustees. The reason is that the normal rules for QCBs already prevent the s 127 treatment from applying where shares (etc) are swapped for a QCB.
- 92 We have not yet had an opportunity to look back at the reasons behind the drafting of s 169R and the transitional rules in para 7, Sch 3, FA 2008. ER is essentially a relief for individuals, and additional complexity generated by the differences between the qualifying conditions for disposals by individuals and trustees may have been factors.
- 93 We would be interested to know if the scope of s 169R has caused any problems in practice.

EXAMPLE E2 – Making the claim for ER

- 94 In CG 63970 of the *Capital Gains Manual* it is stated that a claim for ER should be made in the self assessment tax return. However, a claim by trustees must be signed by the qualifying beneficiary who would not, normally, be a party to the trust tax return.
- 95 Could you clarify what the preferred means of making such a claim should be? How is a claim made when the trust tax return is filed electronically?

HMRC response to Example E2

- 96 Section 169M(2)(a) requires that a claim for ER in respect of a disposal of trust business assets must be made jointly by the trustees and the qualifying beneficiary. As the statute does not provide for any specific method of making the claim there is no preferred means apart from compliance with the legislation. Ideally a joint claim should accompany the trustees' tax return for the year in question. If the return is filed online the claim will have to be sent to the trustees' tax office separately, with a suitable covering note. Help Sheet 275 *Entrepreneurs' Relief* contains a template claim which will accommodate claims made jointly by the trustees and the qualifying beneficiary.

EXAMPLE E3 – Death of a relevant beneficiary

- 97 Can ER be claimed when a post-2006 trust ends on the death of the life tenant?
- 98 For example: the qualifying beneficiary mentioned in s 169J has died, triggering the end of the trust (with the property going to the remainderman). Therefore, there is a deemed disposal (s 71(1), TCGA 1992) which is not exempt (s 73(2A), TCGA 1992).
- 99 If the beneficiary met the qualifying conditions up to the date of death then ER should apply where there is qualifying business property with the trust. However, a valid claim needs to be signed by both the trustees and the beneficiary (or in this case the personal representatives for the beneficiary). Will such a claim be accepted by HMRC?

HMRC response to Example E3

- 100 We can see no reason why ER should not be available in the circumstances described. A joint claim by the trustees and personal representatives of the deceased beneficiary should not cause a problem.

SECTION F – PARTNERSHIPS

EXAMPLE F1 – Fractional partnership shares

- 101 Does HMRC accept that the disposal of a fractional profit share (whether it is a drop from 3% to 2% or from 60% to 59%) will always qualify as a qualifying business asset under s 169I (2)(a), TCGA 1992?

HMRC response to Example F1

- 102 There is no *de minimis* limit for the reduction in partnership share that constitutes the disposal of part of a business.

SECTION G – THE QUALIFYING COMPANY DEFINITION

EXAMPLE G1 – Trading status of a company

- 103 Can a taxpayer apply for a ruling on the trading status of a company?

HMRC response to Example G1

- 104 CG64100 states that ‘a company can seek from HMRC an opinion under the terms of the Non-Statutory Business Clearance service as to its trading status for the purpose of a shareholders ER claim.’

Further query

- 105 To make a valid claim for ER on the disposal of shares it is necessary to know whether the company was a trading company or holding company of a trading group during the relevant period. This is not always clear. CG64100 advises the taxpayer to seek assurance from the company itself and if the company does not know, the company should itself ask for an opinion from HMRC under the Non-Statutory Business Clearance Service.
- 106 The Non-Statutory Business Clearance Guidance at NBCG 2200, however, indicates that the business should only use the clearance service when there is an issue of commercial significance for the business itself. The trading status is only of consequence to the shareholder not to the company, unless the company is also relying on the same definition of ‘trading’ as used for the substantial shareholdings(SSE) for the company (para 10, Sch 7AC, TCGA 1992).
- 107 The two sets of guidance appear contradictory, please could you clarify?

HMRC further response

- 108 NBCG 2200 imagines there is ‘... uncertainty about the tax consequences of a transaction affecting the business’ and while it also says that ‘This is not expected to include applications which clearly fall within the area of personal taxation of individuals ...’, in the infrequent event of there being real doubt about a company’s trading status a non-statutory business clearance application may be appropriate to ensure consistency of view for the purpose of ER for the individual shareholder and SSE for the company.

SECTION H – THE RATE CHANGES AND DEFERRED GAINS

- 109 HMRC has provided the following tables summarising the CGT position where a gain comes into charge after 22 June 2010 where there has been a share-for-QCB exchange (Table 1) or where a gain has been deferred under the EIS or VCT rules (Table 2)

Table 1 – ER and QCBs: HMRC table summarising the various potential outcomes

Date of share-for-QCB exchange	Date of first (part-) disposal of the QCB	Outcomes for gains coming into charge on or after 23 June 2010	Statutory references
before 6 April 2008	from 6 April 2008 to 22 June 2010	<p>Taxpayer's claim to ER on the first part-disposal reduces the remaining held-over gain by 4/9ths (up to the lifetime limit applicable at the time of the first disposal).</p> <p>The reduced held-over gain is liable to CGT at 18% / 28%.</p>	para 7, Sch 3, FA 2008, as originally enacted
before 6 April 2008	on or after 23 June 2010	Taxpayer can claim ER under the transitional rules, as amended, and pay CGT at 10%.	para 7, Sch 3, FA 2008, as amended by para 10 Sch 1 F (No 2) A 2010
from 6 April 2008 to 22 June 2010	not relevant	<p>taxpayer's claim to ER on the exchange reduces the held-over gain by 4/9ths (up to the lifetime limit).</p> <p>The reduced held-over gain is liable to CGT at 18% / 28%.</p>	main ER rules, incl s 169R, TCGA 1992, as originally enacted
on or after 23 June 2010	not relevant	<p>Taxpayers must choose between crystallising the gain on the shares, claiming ER and paying CGT at 10%, or</p> <p>holding over the gain under the normal rules and paying CGT at 18% / 28% when the QCB is disposed of,</p> <p>unless all qualifying conditions are met in relation to the QCB-issuing company and they can therefore claim ER on the held-over gain coming into charge on disposal of that security.</p>	<p>s 169R, TCGA 1992, as substituted by para 8, Sch 1, F(No2) A 2010</p> <p>s 116(10), TCGA 1992</p> <p>s 169I(2)(c), etc. TCGA 1992</p>

Table 2 – ER and EIS deferral relief: HMRC table summarising the various potential outcomes

Date of disposal on which gain deferred under EIS or VCT rules	Date of first ‘chargeable event’ for EIS or VCT shares	Outcomes for gains coming into charge on or after 23 June 2010	Statutory references
before 6 April 2008	from 6 April 2008 to 22 June 2010	<p>Taxpayer’s claim to ER on the first chargeable event reduces the remaining postponed gain by 4/9ths (up to the lifetime limit applicable at the time of the first disposal).</p> <p>The reduced postponed gain is liable to CGT at 18%/28%.</p>	para 8, Sch 3, FA 2008, as originally enacted
before 6 April 2008	on or after 23 June 2010	taxpayer can claim ER under the transitional rules, as amended, and pay CGT at 10%.	para 8, Sch 3, FA 2008, as amended by para 11, Sch 1, F(No 2) A 2010
from 6 April 2008 to 22 June 2010	not relevant	<p>Taxpayer’s claim to ER on the original disposal reduces the postponed gain by 4/9ths (up to the lifetime limit).</p> <p>The reduced postponed gain is liable to CGT at 18%/28%.</p>	main ER rules, as originally enacted
on or after 23 June 2010	not relevant	<p>Taxpayers must choose between claiming ER, or</p> <p>not claiming EIS deferral relief, and paying CGT at 10% on the crystallised gain, or</p> <p>not claiming ER, claiming EIS deferral under the normal rules and paying CGT at 18%/28% when the postponed gain comes into charge.</p>	main ER rules and para 1, Sch 5B, TCGA 1992, as amended by para 9, Sch 1, F(No 2) A 2010

EXAMPLE H1 – What is the treatment of QCBs received between 6 April 2008 and 22 June 2010 in respect of which the held-over gain has, as a result of a claim for ER, been reduced by 4/9ths?

- 110 Clearly, as set out in the above tables, if there is a disposal of the QCB after 23 June 2010, and the holder does not qualify for ER in relation to the issuing company at that time, CGT will be payable on the held-over gain at 18% or 28%, giving an effective rate of 10% or 15.56%. But what if, at the date of disposal of the QCB, the holder does qualify for relief again?
- 111 We recently received a query as to whether an effective rate of 5.56% (5/9 at 10%) would apply if a claim for ER is submitted in respect of the (already reduced) held-over gain when it comes into charge. If the note-holder meets the employment and shareholding conditions at the time of the disposal of the QCB, the disposal will constitute a material disposal within s 169I(c), TCGA 1992. Relief under s 169N(5)(a) will relate to relevant gains 'computed in accordance with the provisions of this Act fixing the amount chargeable gains'. On this basis, we cannot see why the relief cannot be claimed twice, first on the share-for-QCB exchange and, again, on the disposal of the QCBs.
- 112 Please can you either confirm that a double claim is possible or provide a technical analysis of why such a claim would fail?

HMRC response to Example H1

- 113 We can see there is a case for concluding that an effective 5.56% rate of CGT is possible in the circumstances you outline. But the case is not beyond doubt. On the other hand, a 5.56% rate is not plainly impossible. If an actual case arises we would need to arrive at a considered view taking into account any legal advice on the issues.
- 114 The issues may centre around whether the 'frozen gain' that s 116(10)(b) deems to accrue on a disposal of the QCB in question can be a 'relevant gain' on which s 169N gives relief – the 10% rate of CGT. Section 169N(5) defines these gains as, in this context, the gains accruing on the disposal of the QCB. A simple reading could suggest that a 'frozen' gain on a QCB would be a 'relevant gain'. But the words in s 169N(5) need to read as they are written, that is, the gains accruing on the disposal. Two contextual points in ER (Ch 3, Pt 5, TCGA 1992) may have a bearing: first, the meaning of 'relevant gains' in para (b) of s 169N(5) – gains accruing on the disposal of any relevant business assets comprised in the qualifying business disposal; second, the election in new s 169R to allow ER, effectively by preventing the gain in question being 'frozen' under s 116(10).
- 115 It may be that, after taking into account these and all other relevant matters, the better view is that the ER rules do not allow a 'double claim' in the way you suggest.

EXAMPLE H2 – The effect of a change in the lifetime allowance and deferred gains

- 116 Given the way the legislation worked prior to 23 June 2010, where an ER claim was made and the gain was deferred (either as a result of the QCB legislation at s169R or of an EIS deferral claim), it was the gain as reduced by ER that was deferred. It appears therefore that if the gains were in excess of the unused lifetime allowance at the time (eg a gain of £2m realised on 22 June 2008 when the lifetime allowance was £1m) but not the allowance at the date it comes into charge (eg the disposal of the new asset takes place on 18 July 2010 when the lifetime allowance is £5m) it cannot benefit from the allowance increase. Is this HMRC's understanding?
- 117 The issue cannot arise for transactions after 22 June 2010 as the new regime does not allow deferral of the tax liability and EIS relief.

HMRC response to Example H2

- 118 We agree that in any case where ER applies under the original rules then the lifetime limit at the time of the first claim will have fixed the amount of the relief on any deferred gains, even if a bigger lifetime limit is in force at the time the deferral ends.

EXAMPLE H3 – The tax rate where qualifying gains are deferred

- 119 This query relates to cases where individuals are temporarily non-resident but subject to charge under s 10A, TCGA 1992 in the year they return to the UK, or where they are liable to CGT on the remittance basis. Previously, if an individual made a claim for ER, this reduced the amount of the chargeable gain by 4/9ths (the deadline for the claim was based on the disposal date rather than the date it comes into charge, so you could be claiming before it was charged to tax). When the gain came into charge (in the year of return or the year of remittance), the reduced gain was charged at the prevailing rate.
- 120 The relief no longer works as a fractional reduction and s 169N(3) says 'The rate of capital gains tax in respect of that gain is 10% ...'. This seems to indicate that the rate of tax is fixed at the point of disposal, irrespective of the date of the tax charge. So someone could make a gain now, but when it is taxed in one or 20 years' time, it would be taxed at 10%, as it is the same gain. Is this correct?

HMRC response to Example H3

- 121 We see the point being made, but do not believe that this is an issue. If at some future time the Government wishes to alter the 10% ER rate, either upwards or downwards, a policy decision will be needed as to whether to retain the 10% rate on gains deferred from disposals in earlier years.