



**Mark Morton, Head of Mercia's Tax Team,  
expresses his own thoughts on the recently issued  
HMRC guidance on Entrepreneurs' Relief.**

## **Conflicting views on Entrepreneurs' Relief**

You may remember last October and Alistair (aka Captain) Darling's announcement that taper relief was to be abolished. Amid howls of protest from the business community, the Captain (to quote Baldrick) found himself:

'...in the stickiest situation since Sticky the stick insect got stuck on a sticky bun.'

To appease some of those who were losing out, good old Entrepreneurs' Relief (ER) was hurriedly written.

There have been a number of conflicting views regarding the availability of Entrepreneurs' Relief (ER) in certain situations. HMRC have now issued new guidance in their Capital Gains manual. Whilst most of this guidance is unsurprising, there are three particular points which provide some interesting HMRC views.

### **The disposal of whole or part of business**

ER applies to gains arising on disposals of business assets as part of the disposal of the whole or part of a trading business (including professions and vocations but not a property letting business other than furnished holiday lettings) that is carried on by the individual.

To be a material disposal, the individual must have owned the business throughout a period of one year ending with the date of the disposal. The assets must have been in use for the purpose of the business which has been carried on by the individual. Goodwill is specifically included. Assets held within the business but purely as investments do not qualify.

HMRC's view on the disposal of a business is based on Retirement Relief case law. It is not sufficient to have disposed of assets – the requirement is to have disposed of the whole or part of a business and this will be an area of contention under ER as it was

under Retirement Relief. Guidance is still available in HMRC's Capital Gains manual and HMRC have confirmed that they will continue to apply the old Retirement Relief guidance.

The case of *McGregor v Adcock* (51TC692) serves as a reminder of the distinction. The disposal of land by a farmer was held not to be the disposal of a business merely a factor in deciding whether there had been such a disposal. HMRC guidance (CG 63540) states:

'The idea of 'business' as a bundle of activities indicates that you need to identify the full range of activities comprised within that business. If some business activities continue after the disposal you need to identify all the activities relating to a particular part of the business. For retirement relief to be due the whole of those activities must cease when the relevant asset or assets are disposed of. By contrast, if an asset or assets have been sold but no particular activity or set of activities disappeared with the asset disposal, it cannot be said that any part of the business has been disposed of. Retirement relief would not be due.'

### **Disposal of a business – partners**

Partners will be able to obtain ER in a number of situations:

- where an individual makes a disposal of assets used in their own business as part of the entry into a partnership which will continue the business;
- where a partner disposes of the whole or part of their interest in partnership assets, that will be treated as a disposal of part of the business carried on by the partnership; and
- at any time a business is carried on in partnership it will be treated as owned by each individual who is a partner at that time.

The second point is worth reading again.

...where a partner disposes of the whole or part of their interest in partnership assets, that will be treated as a disposal of part of the business carried on by the partnership...

This piece of legislation appears to mean that if an ongoing partnership, such as a farm, sells an asset, such as land, the criteria are met. Partners have sold the whole or part of their interest in partnership assets. The legislation then pretends that this is the part of a business and hence relief is due.

However, the new guidance (CG64040) contains the following comments:

'S169I(8) TCGA 1992 enables partners to qualify for ER:

- a disposal of the whole of their interest in the partnership - by treating it as a disposal of the whole of a business
- a disposal of part of their interest in the partnership - by treating it as the disposal of part of a business

- a disposal BY THE PARTNERSHIP of the whole or part of the partnership business - by treating the business as owned by the individual
- a disposal of partnership assets following the cessation of the partnership business - by treating the business as owned by the individual partner.

*But relief will NOT be available for disposals of partnership assets, unless the disposal constitutes the disposal of part of the partnership business.'*

So whilst the legislation seems to create a difference between ongoing sole trades and partnerships that sell assets, HMRC disagree. Hardly simplification!

### **Associated disposals**

Additionally, relief may be available in respect of an asset owned by a individual personally and used in partnership business or by a company under the associated disposal rules.

The disposal of an asset may qualify for ER if it can be associated with a relevant material disposal. This means that three conditions have to be satisfied:

- the individual makes a material disposal of either the whole or part of their interest in the assets of a partnership or the shares in a company;
- the associated disposal is made as part of the withdrawal of the individual from participation in the business of the partnership or the company; and
- the assets are in use in the business throughout the period of one year ending with the earlier of the date of material disposal of business assets or the cessation of the business of the partnership or company.

### **Withdrawal from participation**

It had been assumed that this phrase meant severing all or most of the ties with the business. However, the legislation would also appear to allow the disposal of one share (provided it qualifies for relief) followed by the associated disposal to qualify. However, HMRC seem have a different interpretation of these words (CG 63955):

'It is not necessary for the individual to actually reduce the amount of work which they may do for the business. For example

G owns a shop from which he trades in partnership with his son. The asset sharing ratio is - G 3/5ths: son 2/5ths. He wishes to reduce his involvement and the shares are then altered to - G 1/5th: son 4/5ths; G also gifts the premises to his son but continues to work full-time in the shop.

R owns a small factory unit which is used by her "personal company", S Ltd of which she is the full-time managing director. She sells both her shares and the unit to another company in a takeover but remains managing director.

In these examples the material disposal (G's reduction of his interest in the assets of the partnership, and R's disposal of her shares) together with the associated disposals (G's gift of the premises to his son and R's sale of the unit) would represent a withdrawal from participation in the business.'

So, whilst the individual does not appear to have to 'retire' to obtain the relief, it does appear from the above that they have to reduce their interest 'materially' – G has reduced his interest by 2/5ths & R sells all of her shares. A rather strange interpretation?

### **Delays between the material and associated disposal**

Where a partnership or company ceases to trade, it is possible that there may be an interval between the material disposal and the disposal of the asset that is the subject of the associated disposal. The legislation does not specify how long the gap can be before the disposal cease to be associated with the material disposal.

HMRC (CG 63995) state:

'In such cases you may accept that a disposal of an asset is associated with a "material disposal" if the asset is disposed of

- within one year of the cessation of a business, or
- within three years of the cessation of a business and the asset has not been leased or used for any other purpose at any time after the business ceased.
- where the business has not ceased, within three years of the material disposal provided the asset has not been used for any purpose other than that of the business.

For example

W, M and S are in partnership running a chain of retail chemists. W owns one of the shops used by the business. He decides to leave the partnership and move abroad. M and S continue in partnership. W intends at the time of leaving the partnership to sell the shop, which continues to be used by the partnership, to M. However M needs time to arrange his finances to allow the sale to proceed. W disposes of the shop to M 18 months after leaving the partnership. So the sale of the shop qualifies as an "associated disposal" under the third bullet point above as the business does not cease, the shop continued to be used in the business and the disposal of the shop takes place within 3 years of W leaving the partnership.

Cases which do not fall within the above guidelines will have to be considered carefully on their particular facts to see whether they meet the requirement of TCGA92/S169K(3). For example if the asset has been used for any other purpose for a significant period following the material disposal, it is unlikely that the conditions for relief will be met.'

### **So there we have it then**

Although the legislation seems to say one thing, HMRC seem to say another. Surely the legislation should be clear and concise and not left to HMRC guidance notes to make up as they go along.

But I suppose that this is what happens when legislation is rushed through parliament to appease those who were shouting loudest.

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