

Entrepreneurs' relief and incorporations

(Lecture P1132 – 7.11 minutes)

When entrepreneurs' relief came into being in 2008, one of the problems for, say, a sole trader who incorporated his business and then sold his shares shortly afterwards was that he did not qualify for the lower CGT rate, given that he had not held those shares for the requisite 12-month period. A shareholder's 'clock' only started once he had acquired his shares in the newly incorporated company and he was not permitted to take into account any prior period when he was a sole trader. It was, of course, possible to make a disapplication election under S162A TCGA 1992, but this facility only provides entrepreneurs' relief up to the date of the incorporation, and not beyond.

The alternative approach of selling the goodwill of the sole trader's business to the new company used to be a possibility, but an entrepreneurs' relief claim in these circumstances has been denied by S169LA TCGA 1992 since 3 December 2014. It is worth noting that this restriction does not apply to the sale of assets other than goodwill.

For share sales taking place on or after 6 April 2019, a taxpayer can now include in the qualifying entrepreneurs' relief period of 24 months both the period when he carried on his sole trader business and the post-incorporation period (see new S169I(7ZA) and (7ZB) TCGA 1992 (as inserted by Para 1(2)(d) Sch 16 FA 2019)). It must be stressed that this aggregation rule only applies where the sole trader (or partnership) has incorporated under S162 TCGA 1992. This means that the whole of the assets of the trade (other than cash) must have been transferred as a going concern in return for an issue of shares in the company. In the event of an incorporation that relies on the holdover provisions of S165 TCGA 1992 or where the assets are sold to the company at market value (with the proceeds being left outstanding on loan account), this new aggregation rule cannot be used.

Illustration

Peter has carried on his tax consultancy business as a sole practitioner for several years. On 1 June 2018, he transferred the business and all its assets (including goodwill) to a new company, Peter Tax Consultancy Ltd, wholly in exchange for an issue of shares.

The net asset value of the business transferred to the company (including goodwill valued at £800,000) was £1,030,000. The capital gain arising on the goodwill, which was Peter's only chargeable asset, was £800,000. This was rolled over under S162 TCGA 1992 against the value of his shares.

On 1 September 2019, Peter sold all his shares in Peter Tax Consultancy Ltd to SHMS plc (a financial services company) for £1,250,000.

Peter had only held his shares for 15 months. However, since he had incorporated his business in consideration for an issue of shares, he is treated as satisfying the 24-month ownership period given that he can add in his time as an unincorporated business.

His gain on the sale of the company will therefore be eligible for entrepreneurs' relief and is computed as follows:

	£	£
Sale proceeds		1,250,000
Less: Cost (= net value of business)	(1,030,000)	
Less: S162 TCGA 1992 relief	<u>(800,000)</u>	
		<u>(230,000)</u>
		1,020,000
Less: Annual CGT exemption		<u>(12,000)</u>
Gain eligible for entrepreneurs' relief		<u>1,008,000</u>

Contributed by Robert Jamieson