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## Section 23 and Schedule 3: entrepreneurs' relief

### Introduction

Schedule 3 to the Finance Act 2020 (FA 2020) provides for the reduction of the entrepreneurs' relief (ER) (renamed as business asset disposal relief (BADR) from 6 April 2020)[1] lifetime gains limit to £1 million for disposals made after 11 March 2020. Thus, from 11 March 2020, qualifying gains exceeding £1 million (reduced by any previous ER claims) will generally be charged at the main capital gains tax (CGT) rate of 20 per cent.

This marks a major scaling back of the previous ER gains limit of £10 million, which has applied since 6 April 2011. The Government justified the reduction on the grounds that the previous relief was expensive, ineffective and unfair.[2] The Chancellor indicated that some 80

[1] See FA 2020 Sch.3, Pt 2, paras 7 and 8.

[2] HM Treasury and The Rt Hon Rishi Sunak MP, speech, *The Budget 2020 speech as delivered by Chancellor Rishi Sunak* (11 March 2020), available at: *https://www.gov.uk/government/speeches/budget-speech-2020* [Accessed 8 September 2020].

per cent of small businesses would not be affected by this change and it would save the Treasury £6 billion over the next five years.

Given the rumours surrounding the possible abolition of, or restrictions on, ER in the run-up to the 2020 Budget, some business owners sought to "bank" their ER entitlement by implementing one of several "planning" techniques. However, these arrangements will invariably be nullified by the special anti-forestalling provisions laid out in paragraphs 4 and 5 of Schedule 3. This is perhaps a surprising move, given that no similar legislation was put in place to deal with planning in advance of the previous abolition of retirement relief[3] (phased out from April 1999) and business taper relief[4] (abolished in April 2008).

The ER anti-forestalling rules have been criticised as being pernicious and retrospective in nature.[5] However, in recent years, HMRC have always indicated that where (artificial) tax avoidance is involved, retroactive rules are "fair game"![6]

From 6 April 2020, the reduced relief has also been renamed as business asset disposal relief (BADR). There is a view that the Government has renamed the relief to distance itself from the generous old-style ER.[7]

### Reduction in lifetime limit

Paragraph 1 of Schedule 3 amends section 169N of the Taxation of Chargeable Gains Act 1992 (TCGA),[8] by providing that the ER/BADR lifetime gains limit is reduced from £10 million to £1 million. Paragraph 2 of Schedule 3 states that this reduction is effective from 11 March 2020 (Budget day 2020).

### Example 1

On 21 July 2020, Alan disposed of his 30 per cent holding in Apollo Twelve Golfing Ltd for £1,400,000. He had already claimed ER against a gain on the sale of goodwill at £170,000, when he sold his small sole trader business in November 2006.

He is entitled to claim BADR of £830,000 against the capital gain of £1,400,000 realised on his July 2020 disposal, calculated as follows:

| | £ |
|---|---|
| Maximum BADR entitlement | 1,000,000 |
| Less: ER used in December 2006 against disposal of goodwill | (170,000) |
| BADR available on 21 July 2020 | 830,000 |

[3] FA 1998 s.140.
[4] FA 2008 Sch.2, paras 23–25.
[5] Chartered Institute of Taxation, *Comments on the Finance Bill 2020: Clause 22 and Schedule 2: Entrepreneurs' Relief (to be renamed Business Asset Disposal Relief)* (2020).
[6] For example, see House of Commons, Briefing Paper, *Retrospective Taxation* (27 August 2020), No.4369.
[7] For example, see Association of Tax Technicians, press release, *Surprise rename of Entrepreneurs' Relief concerns ATT* (20 March 2020).
[8] FA 2020 Sch.3, Pt 1, para.1.

Alan would therefore claim 10 per cent BADR on £830,000. The balance of the gain (ignoring the annual CGT exemption)—£570,000 (£1,400,000 less £830,000)—is taxable at the normal CGT rate of 20 per cent.

**Anti-forestalling: unconditional contracts**

In the run-up to Budget day 2020, many business owners feared that there would be adverse changes to BADR or even its complete abolition. Some of them sought to "bank" their ER at the pre-Budget 2020 levels by arranging for their shares to be transferred to a related party, typically a settlor-interested trust.

This generally involved entering into an *unconditional* contract to transfer the shares but not completing the contract—often referred to as a rescindable contract. This relied on the precedent established in *Jerome v Kelly* (*Her Majesty's Inspector of Taxes*),[9] which firmly established that a CGT disposal can only arise when a contract is completed. However, if the contract were to be subsequently completed, the CGT disposal date is fixed at the date of the contract.[10] On the other hand, if the contract is never completed, no disposal would be triggered for CGT purposes.

Shareholders that entered into pre-11 March 2020 rescindable contract arrangements would have anticipated retaining flexibility. Their intention would have been to only complete the contract after Budget day if it turned out that ER had been adversely affected by the Budget-as proved to be the case! The expectation would have been that their CGT disposal date would be the (pre-Budget day) contract date, so that the previous £10 million ER gains limit would have been available. The base value of the shares in the related entity would have been rebased to market value.

However, where such arrangements are driven by obtaining a tax advantage by exploiting the "contract date" rule, such shareholders will be thwarted by paragraph 3 of Schedule 3.

Arm's length disposals (that is, those not between connected persons[11]) should not, however, be caught by this rule provided that the contractual arrangements had "no purpose"[12] of obtaining a tax advantage under the "contract date" provision. This "let-out" is clearly intended to deal with normal commercial transactions. However, many such deals were accelerated in the run-up to the 2020 Budget and it is hoped that HMRC will adopt a sensible approach when dealing with these. The transferor/seller can only benefit from this "exemption" provided they make a claim including a statement that the "no section 28 advantage" requirement was met. The normal ER/BADR time limit applies to this claim. This will invariably be 31 January 2022.[13]

Where this exemption is available, the CGT date is governed by the normal "contract date" provision. This would fall before 11 March 2020 and therefore the previous £10 million gains limit would apply. On the other hand, if the exemption does not apply, paragraph 3(3) of Schedule 3 treats the disposal date as taking place at the date the asset (such as qualifying shares) is conveyed or transferred for the purposes of the relevant ER/BADR limit. Consequently, the eligible gain would be subject to the £1 million limit (less any previous ER gains claimed).

[9] *Jerome v Kelly (Her Majesty's Inspector of Taxes)* [2004] UKHL 25; [2004] STC 887.
[10] TCGA s.28.
[11] TCGA s.286.
[12] FA 2020 Sch.3, Pt 1, para.3(3)(b).
[13] TCGA s.169M(2)(3).

Paragraph 3(4) of Schedule 3 contains slightly different "let-out" requirements where the parties to the contract are connected. This stipulates that the contract must be entered into "wholly for commercial reasons"[14] and there must be "no section 28 purpose".[15] Moreover, the transferor/seller must make a specific claim that both these requirements are satisfied by the 31 January 2022 deadline (for contracts made in 2019–20). In many cases, transactions were being rushed through before the Budget 2020 in anticipation of adverse ER changes, and it is likely to be difficult to prove that there was no tax motive. In the rare cases where these conditions are met the pre-Budget day ER limit of £10 million is available.

**Example 2**

Virgil is the 100 per cent shareholder of Liberty Bell 7 Ltd (LB7L). In February 2020, he received some informal advice from a friend that—since ER was expected to be abolished on 11 March 2020—he could transfer his shares to a settlor-interested trust to capture his full ER entitlement.

On 1 March 2020, he arranged with a lawyer to transfer 50 per cent of his shares in LB7L for a nominal amount to the trust under an unconditional contract but with completion likely to be deferred until after Budget day 2020, depending on the outcome of any changes to the ER rules. He estimated that the value of his 50 per cent shareholding was around £2.5 million so this would be the consideration value for CGT if the contract was completed.

Fortunately, he told his accountant about this arrangement. His accountant was aware of the anti-avoidance rule in paragraph 3 of Schedule 3 FA 2020 and he advised that the contract should not be completed.

Without his accountant's intervention, the completion of the contract would have triggered a disposal for CGT purposes at some £2.5 million. This would have created a "dry" tax charge but the ER/BADR would have been restricted to the post-10 March 2020 limit of £1 million.

**Anti-forestalling: reorganisations of share capital**

The anti-forestalling measures for deemed share reorganisations under the share exchange rules in section 135 TCGA, and the corporate reconstruction rules in section 136 TCGA, are dealt with by paragraph 5 of Schedule 3 (below) (paragraph 4(4)).

Paragraph 4 of Schedule 3 deals with situations where there has been an internal share reorganisation within section 126 TCGA, between 6 April 2019 and 10 March 2020. In such cases, the normal CGT reorganisation treatment applies. Thus, there is no disposal of the old shareholding and the new (that is, post-reorganisation) shareholding "steps into the shoes" of the old shares.[16]

However, shareholders can make a special election under section 169Q TCGA, to treat the share reorganisation as a disposal at market value to capture ER at this point. Such elections might be made where a shareholder was unable to maintain the relevant BADR/ER conditions after the share reorganisation.

[14] FA 2020 Sch.3, Pt 1, para.3(4)(b).
[15] FA 2020 Sch.3, Pt 1, para.3(4)(c).
[16] TCGA s.127.

The rule in paragraph 4 of Schedule 3 only bites where the relevant ER conditions are satisfied *at 11 March 2020*. Thus, the company must be a trading company or the holding company of a trading group.[17] Furthermore, the relevant shareholder must be an officer/employee of the company (or member of a trading group) and it must be their personal company (broadly, they must hold at least 5 per cent of the company's ordinary share capital, voting rights and economic rights).[18]

Where these conditions are satisfied and the section 169Q TCGA election is made after 10 March 2020, paragraph 4(3) of Schedule 3 requires the BADR/ER limit prevailing at the time of the election to be applied (and not the date of the share reorganisation). This will be at the pre-Budget day limit of £1 million.

Anti-forestalling: exchanges of securities, etc.

Paragraph 5 of Schedule 3 deals with the more prevalent form of pre-Budget 2020 ER planning that took place using the share exchange rules. These anti-forestalling provisions only come into play for share exchanges taking place between 6 April 2019 and 10 March 2020. They effectively thwart the planning intention by applying the same treatment as in paragraph 4 of Schedule 3—the rule ensures that the new £1 million BADR/ER limit is applied to pre-Budget day share exchanges.

Paragraph 5(2) of Schedule 3 effectively deals with "mirror-image" type share exchanges, where the acquiring company's shareholders are the same as those of the "target" (that is, acquired) company. Paragraph 5(3) covers cases where the relevant shareholders (taken together) take a greater share of the acquiring company's ordinary share capital than they previously held in the target company and satisfied the relevant ER conditions on 11 March 2010—the same conditions as in paragraph 4 of Schedule 3 (above).[19]

Under the normal operation of the share for share exchange legislation,[20] the deemed "no disposal" rule[21] often results in the seller being unable to benefit from BADR/ER on a subsequent sale of their "consideration" shares in the acquiring company, for example, because they did not satisfy one of the various 5 per cent share ownership, voting or economic right conditions in relation to that company.

Consequently, sellers are able to elect (under section 169Q TCGA) to opt out of the normal "share exchange" provisions. By making this election, the seller is effectively treated as having made a normal CGT disposal with the value of the acquirer's "consideration" shares being reflected as all/part of their taxable sale consideration. The practical effect is that the seller obtains a step-up in the base value of their consideration shares with BADR/ER being available on the "step-up" gain (albeit in the form of a "dry" tax charge!)

In anticipation of adverse changes to, or the complete abolition of, ER expected in Budget 2020, some owner-managers sought to "lock-in" their existing ER entitlements by arranging for an appropriate share exchange. Typically, this was done by inserting a new holding company "above" the existing company. In the event that ER was abolished or restricted in some way,

[17] As defined in TCGA Sch.7ZA and s.165A.
[18] TCGA s.169S(3).
[19] The legislation is worded so that it does not matter whether an advance TCGA s.138 clearance was given for the share exchange. This prevents any subsequent argument that the share exchange gives rise to an actual CGT disposal pre-Budget day 2020 on the grounds that the tax avoidance rule in TCGA s.137(1) applies.
[20] TCGA s.135—these rules also cover company reconstructions within TCGA s.136.
[21] The "new for old" rule in TCGA s.127 is applied by TCGA s.135(3).

they then intended to make an election after Budget day 2020 (11 March 2020) to "bank" their pre-Budget ER levels.

Once again, this type of advance planning had been anticipated. The anti-forestalling rule in paragraph 5 of Schedule 3 counters this by deeming the section 169Q TCGA election to be given effect at the time it is made and would therefore fix the BADR/ER at the £1 million limit. The election would not therefore access the pre-Budget 2020 level of ER. However, for all other CGT purposes, the rules at the normal disposal date apply.

These provisions also apply to non-qualifying corporate bond (non-QCB) loan notes issued in such cases since they are also covered by a section 169Q TCGA election.

On the other hand, these rules do *not* apply to QCB loan notes. Thus, they have no impact on QCBs that were issued as part of a company sale transaction before 11 March 2020.

**Example 3**

Ed and James have been equal shareholders in Gemini Three Ltd (GTL) since June 1985. They each held 50 shares.

In February 2020, they received some informal advice from a "business colleague" that ER was likely to be "abolished" in the forthcoming Budget. They were also told that they could implement a share exchange, which would enable them to bank their ER entitlements in the event that ER was subsequently abolished.

Therefore on 7 March 2020, they implemented a share for share exchange transaction under which a new holding company—Space Walk Holdings Ltd (Holdings)—acquired 100 per cent of GTL's share capital in consideration of an issue of 998 new Holdings' shares. It was estimated that GTL was worth some £8 million.

Following the reduction in the BADR/ER limit to £1 million in Budget 2020, they asked their accountant to process section 169Q TCGA elections so they could "bank" their prior ER, albeit at a CGT cost of some £800,000 between them. Fortunately, their accountant was vigilant and told them that the election would be imprudent since it would trigger a very substantial "dry" CGT charge, given that the 10 per cent BADR rate was restricted to just £1 million each (the prevailing BADR limit when the elections were intended to be made).

**Interpretation**

Paragraph 6 of Schedule 3 states that these provisions of this Schedule form part of the ER/BADR legislation in Chapter 3 of Part 5 TCGA. It also contains various definitions.

**Re-naming the relief**

From 2020–21 onwards, paragraphs 7 and 8 of Schedule 3 stipulate that ER is to be known as business asset disposal relief (BADR), with all relevant consequential amendments being made to the TCGA to reflect this.

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Business asset disposal relief; Capital gains tax; Entrepreneurs' relief; Reorganisation of capital; Share transfers

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