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Briefing document

Entrepreneurs' relief: Sole trades and partnerships

Introduction

Entrepreneurs' Relief (ER) is a Capital Gains Tax (CGT) relief which reduces the CGT rate on qualifying gains made on disposal of eligible business assets from 20% to 10%. Various conditions must be met. Broadly, ER is available to individuals who are actively involved in a business, whether this is a personally owned business, or operated through a partnership or company.

Each individual is able to claim ER on up to £10million of gains in a lifetime, which can result in a tax saving of up to £1million. Trustees can claim ER if certain conditions are met, which include the trust having an interest in a business in which a trust beneficiary is personally eligible for ER.

This note contains a high-level overview of ER as it applies to individuals' interests in sole trades and to partnership interests held by individuals as partners in partnerships carrying on a business. ER is also available on qualifying interests in trading companies. A separate note on this point is available on request.

A different relief, investors' relief, is available in certain circumstances and also results in a 10% CGT rate. Broadly, ER is relevant to individuals who are actively involved in a business whereas investors' relief is relevant to individuals who are not so involved. A separate briefing note on investors' relief is available on request.

Minimum period over which the ER conditions must be met

- Various conditions must be throughout a minimum period immediately preceding a disposal of business assets in order for ER to be available. This period is currently normally 24 months. A 12 month minimum period normally applied in respect of disposals made before 6 April 2019.
- ER remains available on assets that qualify for ER if the business ceases, provided the assets are disposed of within the three years following cessation and the business was carried on for a minimum period pre-cessation. The minimum period was 12 months for businesses that ceased before 29 October 2018, increasing to 24 months with immediate effect for business cessations on or after 29 October 2018.
- Different time periods can be relevant in some cases, such as on disposal of personally owned assets used by a partnership carrying on a business.

Conditions that must be met in order to qualify for ER

- ER can be claimed on gains made on the disposal of the whole or part of a business carried on by an individual, either on his or her own or in partnership with others. Mere disposal of an asset used in a continuing business does not qualify without a part or whole disposal of the business.
- As noted, ER can be claimed on disposal of assets that were used in a now-ceased business in respect of which the individual was eligible for ER, subject to meeting the above mentioned minimum periods. Additional conditions apply to personally owned assets used by a partnership.

Personally owned assets used by a partnership

- ER may be available on gains made by an individual on the disposal of personally owned assets used by a partnership for at least 24 months before disposal. For disposals made before 6 April 2019, assets must have been used by the partnership for at least 12 months before disposal.
- For ER to be available, the individual must be eligible for ER on his or her interest in the partnership. ER in this case is only available where the disposal is made as part of the individual's withdrawal from the business and provided the individual also disposes of at least a 5% interest in the assets of the partnership.
- ER is also available to individuals on disposal of assets used by a partnership in cases where the individual has less than a 5% partnership interest, provided the individual disposes of their entire partnership interest

and had at least a 5% partnership interest for a continuous period of three of the eight years preceding the disposal.

- In addition to the above conditions being met, the asset disposed of must have been owned for at least three years immediately preceding the disposal.
- Relief is restricted on a just and reasonable basis where:
  - The asset was not used in the business throughout the ownership period, or;
  - The asset was only used partly for business purposes, or;
  - The individual charged the business rent for use of the property.

Trusts
ER is only available on the disposal of trust business assets where an individual is entitled to the income received by the trust from the business assets in question (an 'interest in possession'), and provided that individual qualifies for ER on the business on his or her own account.

Trustees may be able to claim ER within the three years following cessation of the sole trade business or partnership trade, provided the usual ER conditions are met and provided that the aforementioned individual ceases carrying on the business within that three year period.

Lifetime limit
Each individual is able to claim ER on a maximum of £10million of gains in a lifetime, which can result in a tax saving of up to £1million (or £2million for a couple). There is no requirement to use the entire lifetime limit on one transaction; instead ER can be claimed throughout an individual's lifetime as qualifying gains arise.

ER claims on trust gains use part or all of the lifetime limit of the beneficiary who personally qualifies for ER.

Gains realised in excess of the available lifetime limit are taxable at the prevailing CGT rate, which is currently 20% for higher and additional rate taxpayers and trustees on most gains (a 28% rate applies on residential property and carried interest gains).

Claiming ER
ER must be claimed by the second 31 January following the end of the tax year in which the qualifying gain arose. If ER is to be claimed on trust gains, the trustees and beneficiary whose lifetime limit will be used must make a joint election. The deadline to claim ER on gains realised in 2019/20 is 31 January 2022.

Points to note
- Taxation of capital gains can be deferred to a later date when a qualifying Enterprise Investment Scheme (EIS) investment is made. ER can be claimed when deferred capital gains become chargeable, provided the gain was eligible for ER when it was realised and provided the gain was originally realised after 2 December 2014. ER is claimed when the gain comes back into charge. There are a small number of other cases where ER may be available on a previously deferred gain coming back into charge.
- When a business is incorporated and the requisite conditions are met, no chargeable gain is triggered on the disposal of the individual's interest in the business in exchange for shares in a new company. Instead, the individual will be liable to CGT if they realise a capital gain on an eventual disposal of their shares. It is possible to opt out of this automatic relief on incorporation, which may be preferred where ER is available at the date of incorporation, but is unlikely to be available in the future. ER is restricted in some circumstances to the extent that a gain realised on incorporation relates to goodwill.

Find out more…
This note reflects the law in force as at 8 August 2019. Please be aware that this note does not cover all aspects of this subject. To find out more about any aspect of the above, please discuss with your usual Deloitte contact. If you do not have a usual contact, please contact Michelle Robinson (michellerobinson@deloitte.co.uk).

For further information visit our website at www.deloitte.co.uk.