

# Entrepreneurs' Relief

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1st edition

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## **2. Qualifying shareholders**

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### **2.1 Overview**

In order for an individual to make a claim for entrepreneurs' relief in respect of a holding of shares, he must meet the shareholder tests.

This section will:

- consider the tests that apply to individuals;
- look at planning opportunities that might arise; and
- set out the pitfalls to be aware of.

### **2.2 What is a qualifying shareholder?**

A business asset for the purposes of entrepreneurs' relief includes shares in a company.

To be a qualifying shareholder:

- the shares (or loan stock, securities, etc.) must be in the individual's personal company (see **2.5** below);
- the company must be a trading company, or holding company of a trading group; and
- the individual must be an officer or employee of the company, or of a company within the group.

These conditions are discussed in more detail below.

**Law:** TCGA 1992, s. 169I(2)(c)

### **2.3 One-year rule**

Generally, in order to claim entrepreneurs' relief in relation to shares, the individual must satisfy the conditions for the period of at least one year prior to disposal. There are exceptions to this, for example in the case of a takeover or reorganisation, or in spouse transfers, but these are discussed specifically in later chapters.

Where the company has ceased trading, the conditions must be met for the period of one year prior to disposal, and the shares must be sold within three years of trade ceasing.

In the case of shares held in an EMI scheme, the requirement is one year from the date of grant.

**Law:** TCGA 1992, s. 169I(6)

## **2.4 What is an office or employment?**

### **2.4.1 Significance**

Where there is a disposal of shares, one of the conditions is that the individual making the disposal must be an officer or an employee of the company.

In order to determine whether this condition is met the CGT legislation requires us to look at the meanings given in ITEPA 2003, s. 4 and s. 5(3).

**Law:** TCGA 1992, s. 169S(5)

### **2.4.2 Definition of “employment”**

“Employment” for these purposes includes:

- a contract *of* service;
- a contract *of* apprenticeship;
- any employment in the service of the Crown.

**Law:** ITEPA 2003, s. 4

### **2.4.3 Definition of “office”**

The term “office” for these purposes includes any position which has an existence independent of the person who holds it, and can be filled by successive holders.

There is no statutory definition of an “office” so the question of whether there is one will be based on the relevant facts.

Detailed guidance may be found in HMRC’s *Employment Status Manual*. There is also extensive case law, including in particular the comments made by Rowlatt J in *Great Western Railway Company* and the case of *Edwards v Clinch*.

**Law:** ITEPA 2003, s. 5(3)

**Cases:** *Great Western Railway Co. v Bater* (1922) 8 TC 231; *Edwards v Clinch* (1981) 56 TC 367

#### **2.4.4 Case law specific to entrepreneurs' relief**

There have recently been a couple of key cases in this area which give us an indication of how the Courts approach the concept of employment for entrepreneurs' relief purposes.

##### ***Hirst***

In September 2014 the case of Richard Hirst went before the First-tier Tribunal. The taxpayer appealed against HMRC's decision to disallow an entrepreneurs' relief claim on the basis that the taxpayer was not an employee or an officer of the company for the 12 months leading up to the disposal of his shares.

The background was that in December 2007 the taxpayer resigned from his position as managing director in order to control costs. In 2008 he was found guilty of assault as a result of which he was unable to resume his former role.

He did, however, continue to carry out work for the company. The taxpayer argued he was a "*de facto* director" or a "shadow director", the statutory definitions of which are found in *Companies Act 2006* s. 250 and s. 251 respectively.

The Tribunal decided he was not in fact a *de facto* director or a shadow director of the company. However, the Tribunal stated:

"We consider the work undertaken by Mr Hirst between December 2007 (when he resigned his directorship) and the sale of his shares in July 2009 was significant ... We consider they constitute the elements of an employment relationship between the company and Mr Hirst."

On this basis the appeal was allowed.

This is an interesting case for anyone giving up their formal post prior to the sale of shares, providing they demonstrably continue to work for the business.

**Case:** *Richard Hirst v HMRC* [2014] UKFTT 924 (TC)

##### ***Corbett***

In March 2014 the First-tier Tribunal heard *Susan Corbett*. HMRC disallowed her claim for entrepreneurs' relief in respect of a disposal of shares in 2009-10. The taxpayer provided clerical

services to her husband who was a director of the company. She sometimes provided services to other people in the company.

When the company was to be sold, the purchaser had a policy not to employ spouses. They therefore agreed to issue her with a P45 and increase her husband's salary accordingly.

The Tribunal found that Mrs Corbett remained as an employee:

“We accept that the motivation for removing Mrs Corbett from the payroll ... was to keep her out of sight of the potential purchaser.”

The appeal was accordingly allowed.

**Case:** *Susan Corbett v HMRC* [2014] UKFTT 298 (TC)

#### **2.4.5 Length of office or employment**

To satisfy the employment condition, the individual must have held the position, or office, for at least one year up to the date of the disposal of shares.

There is no minimum working hour requirement to satisfy this condition, so part-time employees and officers are eligible.

**Law:** TCGA 1992, s. 169I(6)

### **2.5 The personal company requirement**

#### **2.5.1 Overview**

In order for a disposal of shares to qualify for entrepreneurs' relief, the disposal must be in the individual taxpayer's personal trading company.

A personal company means that the individual owns at least 5% of the ordinary shares in the company, together with at least 5% of the voting rights.

The trade requirement is considered in detail at **3.2** below.

**Law:** TCGA 1992, s. 169S(3)

#### **2.5.2 What is ordinary share capital?**

Ordinary shares are given the same meaning as in ITA 2007, s. 989, which states that ordinary share capital is:

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