

# Check your Entrepreneur's Relief (ER) position

*The last year has seen both legislative changes to the ER rules and also an increase in HMRC compliance and case law.*

Two of the changes in FA 2019 had the effect of making claims to ER on shares more stringent by:

- increasing the ownership period from 1 to 2 years; and
- requiring that the individual is beneficially entitled to at least 5% of the profits available for distribution to equity holders and, on a winding up, would be beneficially entitled to at least 5% of assets so available; or
- in the event of a disposal of the whole of the ordinary share capital of the company, the individual would be beneficially entitled to at least 5% of the proceeds.



## Tribunal examines claim

In addition to these changes, there have been a number of Tribunal cases critically examining claims. The case of TC07057: Philip Hunt First-tier Tribunal March 2019 is particularly interesting.

The taxpayer was a shareholder and chairman of a web analytics company. He had been involved in the company since 2007, initially only investing £50,000 for which he received 10p shares. The company's other issued shares had £1 nominal value each.

By 2014, through further investments, share buy-backs and exercised share options, he owned 73,448 'E' ordinary 10p shares and £100,000 'B' ordinary £1 shares. All the shares carried voting rights. On the basis of share numbers, the taxpayer had 5.94% of the total issue and with regard to voting power he had 6.21% of the company's votes. However, he only possessed 4.16% of the company's nominal share capital.

In 2015 the company was sold to Ernst Young who, during the course of negotiations, had told the taxpayer that his holding was unlikely to qualify for ER on the basis that he did not own 5% of the nominal share capital. However, the taxpayer ignored this advice. When he claimed ER through his tax return, HMRC denied the relief and upon closing their enquiry increased the taxpayer's liability by £199,751.

## 'Ordinary share capital'

None of the other ER criteria were in issue but HMRC argued that 'ordinary share capital' meant the nominal value, of which the taxpayer owned less than the requisite 5%. S989 ITA 2007 defines ordinary share capital as issued share capital, which reinforced HMRC's argument that 5% of ordinary share capital meant 5% of the nominal value of the shares in issue.

## Taxpayer argued for a broader definition

The taxpayer argued that the definition should be broader, taking into account the real and material commitment to the business and that the Tribunal should take a 'purposive, multi-factorial approach'. However, the Tribunal agreed with HMRC's arguments. As to the argument about taking a purposive and multi-factorial approach, the Tribunal conceded that such an approach is often taken in other areas of tax law (e.g. employment status, VAT, status) but that the ER legislation is highly prescriptive.

It was therefore not possible to replace the statutory definition of issued share capital with a wider interpretation or infer anything other than that laid down in detailed provisions. The Tribunal concluded that:

'The statutory definition refers to a percentage of a company's "issued share capital", not to a percentage of a number of shares.'

The appeal was therefore refused.

## Consider implementing a policy of annual reviews

This is a case where the taxpayer was unable to meet the older, easier definition of ER. Now the rules have changed, it may be worth implementing a policy whereby the position of clients is reviewed annually to ensure compliance with the rules.



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