

Finance Bill 2019 – Proposed relaxation of entrepreneurs' relief rules

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The proposed amendment to entrepreneurs' relief ("ER") in Finance Bill 2019 is designed to address one of the outstanding issues with the current law when dilution of a company results in the loss of ER. Under the current rules, a shareholder who has held, for at least 12 months prior to disposal, at least 5% of both the ordinary shares and 5% of the voting rights in a trading company (or holding company of a trading group) and is also an officer or employee of the relevant company can benefit from a lower rate of capital gains tax (10%) on the chargeable gain at time of disposal.

However, an issue of new shares, usually upon a new investment into the company, can reduce an individual's percentage shareholding below the required 5% holding threshold. If this occurs, the individual would lose any ER completely, even in respect of the gain which accrued when the required threshold was satisfied. This consequence has been seen as a barrier to growth for companies.

The proposed amendment will allow individuals, where an issue of shares will lower their holding below the 5% threshold, to elect to crystallise a gain by deeming a disposal and reacquisition of their shares or securities at market value immediately before an issue of shares. Any gain that has accrued up until that point will still qualify for the lower, 10% rate of capital gains tax. The individual can also elect to carry forward the gain, retaining the 10% ER rate, to a time when the individual actually sells the shares to avoid a dry tax charge. Further gains which accrue after the issue of shares will be taxed at the standard 20% CGT rate.

The new proposals will only apply where the share issue which creates the dilution is made wholly in cash, for genuine commercial reasons and not to secure a tax advantage. The new rules will apply for share issues which occur on or after 6 April 2019.

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