

# Dunkley's

Chartered Accountants  
& Statutory Auditors

## Ahead of the curve for your business



### Government waters down entrepreneurs' relief rules

Further to our notes regarding the plans put forward in the 2018 Budget with respect to entrepreneur's relief, which restricted the appropriate use of Alphabet shares, the Government have now agreed to make amendments which protect businesses from the measures that were being brought in to overcome misuse.

Under the improved rules, shareholders are required to meet one of the two alternative 'economic interest' conditions – Economic Condition 1 and Economic Condition 2.

#### **Economic Condition 1**

Economic condition 1 reflects the original proposed rule, which required the seller shareholder to be beneficially entitled to at least 5% of the profits available for distribution to the company's equity holders, and the company's assets available for distribution to its equity holders on a winding-up.

#### **Economic Condition 2**

Economic condition 2, the alternative (new) test is likely to be easier to apply.

In the event of a disposal of the ordinary share capital of the company

the individual would be entitled to 5% of the disposal proceeds.

This seller must meet this condition throughout the ER qualifying period. However, in applying this provision, the sale value of the company is taken to be the market value at the end of that period. In those cases, where the seller is selling as part of a disposal of the entire company, it is expected that the arm's length sale price would be used.

'The way the rules were worded under the draft proposals, tax advisers considered that the original 'economic test' (i.e. Economic Condition 1 above), which looks at profits available on a distribution, would have potentially prevented holders of 'alphabet shares' from being able to make competent ER claims.

This was largely due to a faulty design in the original 'economic test', since it was not HMRC's policy intention to deny relief where a shareholder had a right to at least 5% of the total sale proceeds on a sale of the company.

'The alternative (new) Economic Condition 2 is likely to be the preferred test for holders of

alphabet shares and similar share structures. If a shareholder holds a separate class of shares, they can meet this condition where (under the articles or shareholders' agreement) they would obtain at least 5% of the proceeds on a sale of the company

We are pleased to see that HMRC has largely resolved the alphabet share ER debacle – a very welcome start to the new year.

**If you have any questions or require any advice with regards to this, please call our specialists on 01454 619900.**

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