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# Capital Gains Tax Entrepreneur Relief

This article looks at the main conditions that need to be satisfied by an individual in order to obtain Capital Gains Tax Entrepreneur Relief.

## 1. Introduction

To encourage investment by individual entrepreneurs, a number of years ago a reduced rate of capital gains tax was introduced ("CGT Entrepreneur Relief") on the sale of certain assets subject to satisfying certain conditions.

Over the years a number of legislative amendments have been made to CGT Entrepreneur Relief and since 1 January 2017, under Section 597AA of the Taxes Consolidation Act 1997, the rate of capital gains tax ("CGT") that applies when CGT Entrepreneur Relief is relevant is 10%.

The amount of qualifying "chargeable business asset gains", discussed further in section 2 below, on which an individual can obtain the benefit of CGT Entrepreneur Relief is a lifetime cap of €1m.

With the recent upturn in the economy and the resultant increase of individuals selling assets, particularly shares in merger and acquisition deals, the purpose of this article is to look at the main conditions that need to be satisfied by an individual to obtain CGT Entrepreneur Relief and outline some considerations and pre-sale actions when assessing whether clients can avail of the relief.

## 2. Conditions for CGT Entrepreneur Relief

In order for CGT Entrepreneur Relief to be available the main conditions to be satisfied by an individual are:

- a. The asset(s) disposed of must be "chargeable business assets"; and
- b. The individual making the disposal must be a "relevant individual" and if that individual is disposing of a shareholding that person must also be considered a "qualifying person".

These definitions can be further explained as follows:

### 2.1 Chargeable business assets

Chargeable business assets are generally:

- a. Assets owned by a sole trader and used in their trade including goodwill once the business operated is a "qualifying business". A share of assets owned by an active partner in a trading partnership should also qualify; and
- b. Shares held by an individual in a trading company that operates, wholly or mainly, a qualifying business or in a holding company of a qualifying group (discussed below), once the shareholding held is 5% or more of the issued ordinary share capital of the relevant company (even though the entire shareholding does not need to be sold).

A qualifying business is any business other than a business of:

1. The holding of securities or other assets as investments;
2. The holding of development land; or
3. The development or letting of land.

A group of companies cannot be a "qualifying group" if any of the holding company's 51% subsidiaries carry on a business that is not a qualifying business, e.g. developing or letting of land or carry on no business, i.e. a dormant company. Given that many family group companies will hold property in a separate group company to segregate valuable property from commercial litigation this can cause issues when seeking to claim CGT Entrepreneur Relief on a sale of the group.

Situations can arise where a holding company could own a dormant company in its group, e.g. non-disclosure structure and on a technical basis a "qualifying group" does not exist.

We are aware Revenue previously granted a concession to allow a non-disclosure structure to be considered a qualifying group, even though it contained a dormant company. If such a case arises for members and it is not possible to remove the dormant company pre-sale we would suggest making a submission to Revenue, given the concession granted is contrary to the published Revenue position.

Finally, we do understand that Revenue by concession allow a Double Holding Company Structure to be considered a qualifying group for the purposes of CGT Entrepreneur Relief.

## 2.2 Relevant individual

To qualify as a "relevant individual" the chargeable business assets must have been beneficially owned by the individual for a continuous period of three years in the five years immediately prior to the sale of those chargeable business assets.

Unfortunately, any previous period of ownership of the assets by a spouse is not aggregated in determining the continuous period of three years nor does any period of ownership as a sole trader prior to the incorporation of a business.

Any period during which the individual owned shares in or was a director or employee of a company that qualified for CGT reliefs under restructuring provisions, may be considered for the purpose of the three-year ownership and director or employee requirements.

## 2.3 Qualifying person

To be considered a qualifying person the individual must have been a director or employee of the qualifying company (or companies in a qualifying group) who is or was required to spend not less than 50% of his or her time in the service of the company or companies in a managerial or technical capacity and has served in that capacity for a continuous period of three years in the five years immediately prior to the sale of the chargeable business assets.

There are currently two views as to how the working time condition must be satisfied when claiming CGT Entrepreneur Relief. The first is that the individual must spend 50% of their available working

time in the business and that time must be in a managerial or technical capacity. The alternative view of interpreting the provision is that the entrepreneur has worked only part time in the business for the required period and 50% of that time must be in a managerial or technical capacity. It is likely Revenue might challenge the latter interpretation, so should a client be seeking to rely on that interpretation we would strongly suggest seeking confirmation from Revenue on the point.

## 2.4 Liquidations

A question that is commonly asked is whether CGT Entrepreneur Relief can apply on a liquidation of a company and one which is not provided for in the relevant legislation.

On tax first principles, a capital distribution received by a shareholder in respect of their shares on liquidation would not qualify for CGT Entrepreneur Relief, as a company is generally not trading, i.e. not operating as a "qualifying business" at the time at which it is dissolved by the liquidator and the distribution made.

It can also be the case that even at the date a liquidator is appointed, a company is not carrying on any activity or has wound down its activities significantly.

However, Revenue provided a limited concession in their CGT, Tax and Duty Manual at Part 19-06-02b (last updated in February 2018) which states the following:

*"Relief can apply on the liquidation of a company, provided the company was carrying on a qualifying business up to the time the liquidator was appointed and the liquidation was completed within a reasonable period of time."*

Once a company liquidation is completed within two years<sup>1</sup> from the appointment of the liquidator and the relevant company carried on a qualifying business up to the appointment of the liquidator, then relief should be available provided the other conditions for relief are satisfied and the company is still trading prior to the appointment of the liquidator. Finally, the concession would not apply to the liquidation of a holding company, as the holding company would not have carried on a qualifying business prior to the appointment of a liquidator.

## 3. Recent changes to the relief

Due to Revenue's perception of abuse of the relief the definition of chargeable business assets was amended in Finance Act 2017 and since 2 November 2017 no GGT Entrepreneur Relief can be claimed on:

- a. Non-share consideration (e.g. cash) received by a seller for the sale of a business on incorporation if the seller is connected to the company after the sale; and
- b. Goodwill, shares or securities sold to another a company if the seller is connected to the company after the sale of those assets.

The above exclusion from the definition of chargeable business assets will not apply where it can be shown the transaction is made for bona fide commercial reasons and did not form part of any arrangement or scheme, the main purpose of which was tax avoidance.

## 4. Interaction with CGT Retirement relief

One of the most common queries we receive with regard to CGT Entrepreneur Relief is its interaction with CGT Retirement Relief, particularly given that both reliefs have mandatory application to the sale or transfer of assets.

When CGT Retirement Relief applies to a sale or transfer of "qualifying assets" by an individual any gain arising is relieved from CGT. By comparison, CGT Entrepreneur Relief reduces the rate of tax at which CGT is payable up to the €1m lifetime limit for chargeable business asset gains.

As the reduced rate of CGT available under CGT Entrepreneur Relief contains a lifetime limit of €1m on chargeable business asset gains since 1 January 2016 it is important that any prior sales or transfers of any chargeable business assets on which gains arose and on which no CGT may have been paid due to CGT retirement relief applying, are aggregated in determining whether the €1m threshold has been exceeded and if so 33% tax is applied to the excess.

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### 5. What action should be taken before advising?

It is our experience that clients will reach out to their accountant as a trusted adviser, even if not tax specialists, to seek a preliminary view as to whether CGT Entrepreneur Relief might apply to a sale of chargeable business assets, typically a share sale.

To ensure no loss of goodwill with these clients before advising or offering a preliminary review we would suggest the following action is undertaken:

3. Review all the conditions for the relief including the current structure of the business and all assets held to consider any pre-sale planning that might be required;
4. If the proposed sale is of a shareholding, ensure that the individual satisfies the working time condition to be considered a qualifying person;
5. If the main trading business is carried on by a group company and a sale of shares will possibly not qualify for relief can any pre-sale planning be implemented, or Revenue concession obtained to ensure relief might be available;
6. Enquire about (if not originally involved) and review any previous sales or transfers of "qualifying assets" on which CGT Retirement Relief was claimed after 1 January 2016 to determine if those transfers might change the level of CGT Entrepreneur Relief;
7. If CGT Retirement Relief is expected to be claimed on the sale or transfer of another asset, consider the timing of those transactions to ensure CGT Entrepreneur Relief can be maximised; and
8. If the position appears complicated seek advice or at least get a second opinion from a tax specialist.

### 6. Conclusion

CGT Entrepreneur Relief is a favourable relief of up to €230,000 to an individual and is expected to increase in the coming years. However, given that the relief contains similarities to other CGT reliefs it can at times not be as straightforward as one would initially expect so approach it with caution when asked to provide advice or assistance with the claiming of this relief.

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