

## **New Capital Gains Tax Entrepreneurs' Relief: A Welcome Relief?**

Alastair Darling announced on Thursday the introduction of a new capital gains tax (CGT) entrepreneurs' relief from 6 April 2008. The Chancellor had been under considerable pressure to rethink the radical changes to the CGT regime that he announced in his first Pre-Budget Report in October last year. The sudden and sweeping nature of the CGT reforms sent shock waves through the business community and led to vociferous representations being made to the Government by a range of business leaders and professional bodies.

The introduction of a new CGT relief is certainly welcome news. The extent of the relief and what its impact will be in practice, however, must be carefully considered before deciding whether this has been an embarrassing climb-down for the Chancellor or if it merely reflects a minor change to appease the 'baying crowds'.

### **The changes announced last October – a reminder**

The radical changes to CGT announced back in October remain intact and draft legislation has now been released. The following changes will take effect in just over 2 months time from 6 April:

- the introduction of a flat rate of CGT of 18% for individuals and trusts realising gains (the proposals do not affect companies)
- the abolition of indexation allowance
- the abolition of taper relief

The new entrepreneur's relief will, therefore, be taking its place as a welcome addition rather than an amendment to these changes.

### **What is entrepreneurs' relief?**

It is proposed that the relief will apply to those who realise capital gains on the disposal of:

- all or part of an interest in a business (e.g. sole-trader, partnership, LLP, etc..)
- assets following the cessation of a business
- certain shares in a "qualifying" trading company

There will inevitably be a number of conditions to be satisfied for a disposal to qualify for the new relief. The following points can be taken from the press notices that accompanied the Chancellor's announcement:

- the first £1 million of lifetime qualifying gains will be charged to CGT at an effective rate of 10%
- gains in excess of £1 million will be charged at the new flat rate of 18%
- every individual will be given a lifetime allowance of £1 million of qualifying gains starting from 6 April
- the relief will continue to apply to qualifying disposals made by the individual until the £1 million lifetime allowance has been completely used
- qualifying conditions will require to be satisfied for a period of at least one year prior to the disposal

The following example demonstrates the potential impact of the new relief in practice:

Gordon sells his trading business and realises qualifying capital gains of £2 million. Gordon has owned the business for over 2 years and has made no other qualifying disposals in the tax year. Gordon's tax exposure will depend on whether the business was disposed before or after the end of the current tax year on 5 April.

	<u>Disposal on or before 5 April 2008</u>	<u>Disposal after 5 April 2008</u>
	£	£
Qualifying capital gain	<u>2,000,000</u>	<u>2,000,000</u>
<u>CGT</u>		
10% tax rate	200,000	100,000
18% tax rate		<u>180,000</u>
<u>Total</u>	<u>200,000</u>	<u>280,000</u>

The £280,000 CGT liability that Gordon potentially face on a post 5 April 2008 disposal compares favourably to the £360,000 CGT liability that would have arisen without the new entrepreneurs' relief being available (£2 million @ 18%). Gordon will still, however, be at least £80,000 worse-off than if CGT business asset taper relief had still been available. Gordon will also not be able to benefit from entrepreneurs' relief in the future because the capital gains are in excess of £1 million.

### What will the impact be for you?

The potential impact, if any, on you will very much depend on the type of business interests you hold.

#### 1. Business owners

The relief will apply to gains arising on the disposal of the whole or part of a trading business that is carried on by an individual either as a sole-trader or in partnership. Capital gains on assets formerly used in a business may also qualify for this relief if the disposal takes place within 3 years from the termination of the business.

#### 2. Shareholders

Shareholders will qualify for the relief if all of the following conditions are satisfied:

- the shares (or securities) are in a "qualifying" unquoted trading company (or the holding company of a trading group);
- the individual has been an officer (e.g. director) or employee of the company; and
- the individual owns a "material" stake (at least 5% of the ordinary share capital)

This will come as welcome news for certain employees who hold shares representing at least a 5% interest in the company. This will, however, be of

little comfort to a great number of employees who own shares in their employer below this minimum amount.

### **3. Land and property owners**

The new entrepreneurs' relief will be available, in limited circumstances, to the disposal of land or property used in a "qualifying" business if it is "associated" to the disposal of the business itself. The relief will equally apply to other assets owned by an individual used in their business. The amount of relief will be restricted if the asset in question was not used in the business throughout the duration of ownership.

### **4. Trusts**

Trustees of certain types of trusts may also be able to benefit from the new relief on capital gains arising from the disposal of qualifying shares and assets used in a business.

### **What should I do now?**

The introduction of a new tax relief should always be welcomed (even when it goes against the Government policy of tax simplification!). It is arguable that the Chancellor has introduced this new relief as a concession to those representations made by the by the business community without the embarrassment of having to withdraw the changes announced in October.

This new relief may stop some taxpayers in their tracks who were thinking about disposing of certain business interests prior to 5 April 2008 in order to benefit from the generous 10% effective rate currently available to them. Instead now, if the capital gains expected on the sale of their business assets falls under the £1 million lifetime allowance, they will still enjoy a 10% CGT rate post 5 April. But, the level and extent of the new relief still does not compensate for the savings available through a combination of indexation allowance and taper relief. At first sight it would appear the maximum CGT tax saving will be capped at £80,000 (i.e. the difference between the 10% and 18% rates on the first £1 million of gains).

Taxpayers (and more importantly their advisers!) will now, more than ever have to keep accurate records of qualifying disposals to monitor when the £1 million limit has been reached. One of the early criticisms of the new relief is that it offers little consolation to serial entrepreneurs making gains in excess of this limit over the course of their working lives. Having said that, the new relief should offer tax planning opportunities, especially for those involved in a family business.

It remains important to consider taking action prior to the abolition of indexation allowance and taper relief on 5 April. You might, for example, be in a position to "bank" your accrued indexation allowance on assets you have owned for a long time by arranging a simple tax-free transfer of title to your spouse. But before acting, remember it is important that the tax tail is not allowed to wag the commercial dog! – in other words if you would not have acted for commercial reasons be careful of doing so just for tax reasons.

The information set out in this ezine is based on the documents released by the Treasury following its recent announcement and is intended only for guidance. We would strongly recommend you seek professional advice before taking any action.

The draft legislation is not currently available and as always the devil will be in its detail.

For further advice in relation to how these and any other changes will impact, please speak to your usual Anderson Strathern contact or contact Colin Henderson, Bruce Connelly or Martin Campbell.