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Last October the government announced some major changes to capital gains tax (CGT) for individuals and trustees, but not companies, for 2008/09. These include, for disposals and held over gains arising on or after 6 April 2008:

- the withdrawal of taper relief;
- the withdrawal of indexation allowance;
- simplification of the share identification rules; and
- a new single rate of CGT of 18%.

The annual exemption remains and for 2008/09 this is £9,600 for each individual. This exemption allows the first element of gains for each individual made in a given tax year to be exempt from CGT.

The Chancellor has also introduced a new relief with effect from 6 April 2008 so that some business owners will continue to have the potential benefit of a 10% rate of CGT.

Entrepreneurs' Relief

The new £1m relief

What is the new relief?

After business leaders voiced their objections to the abolition of taper relief, the Chancellor has introduced a new Entrepreneurs' Relief (ER). ER may be available for disposals, reorganisations and relevant transactions taking place on or after 6 April 2008.

The main effects of this relief are:

- an individual will be able to make more than one claim for relief, up to a lifetime total of £1m of gains;
- the first £1m of gains qualifying for relief will be charged at an effective rate of 10%; and
- gains in excess of £1m will be charged at 18%.

The new relief is similar to Retirement Relief, which was phased out with the introduction of taper relief, but under the new rules:

- there will be no minimum age limit; and

- relief will generally be available where the relevant conditions are met for a period of one year.

Which gains qualify for relief?

The relief may apply to gains arising on the disposal of:

- the whole, or part, of a trading business that is carried on by the individual, either alone or in partnership;
- shares in a trading company, or holding company of a trading group, provided that the individual holds broadly 5% of the shares and voting rights and has been an officer or employee of the company;
- assets used by a business or a company where the trade has ceased; and
- assets used in a partnership or by a company but owned by an individual if the assets disposed of are 'associated' with the withdrawal of the individual from participation in the partnership or the company.

ER - impact

The effect of the relief is to reduce the gains liable to CGT at 18% by 4/9ths, resulting in an effective rate of 10% (18% x 5/9ths). The relief will be available for gains of up to £1m for qualifying disposals by an individual throughout their lifetime. The impact of this new relief on qualifying disposals can be seen in the following table (ignoring the annual exemption).

Gain	Qualifying for ER	Amount of ER	Chargeable gain	Tax	Effective rate
250,000	250,000	111,111	138,889	25,000	10%
500,000	500,000	222,222	277,778	50,000	10%
750,000	750,000	333,333	416,667	75,000	10%
1,000,000	1,000,000	444,444	555,556	100,000	10%
1,250,000	1,000,000	444,444	805,556	145,000	11.6%
1,500,000	1,000,000	444,444	1,055,556	190,000	12.7%
1,750,000	1,000,000	444,444	1,305,556	235,000	13.4%
2,000,000	1,000,000	444,444	1,555,556	280,000	14%
3,000,000	1,000,000	444,444	2,555,556	460,000	15.3%
4,000,000	1,000,000	444,444	3,555,556	640,000	16%
5,000,000	1,000,000	444,444	4,555,556	820,000	16.4%

A trading business includes professions but only includes a property business if it is a 'furnished holiday lettings' business. 'Trading company' has the same meaning as applied for taper relief.

Similar rules operate where the trustees of a settlement make a disposal of business assets and there is an individual who is a qualifying beneficiary. There are however a number of specific conditions which need to be met to treat the individual as a qualifying beneficiary.

Continued overleaf >>>

ER will have to be claimed by the individual or, in the case of a disposal of trust business assets, jointly by the trustees and the qualifying beneficiary.

Where a claim is made, gains and losses of all relevant disposals are to be aggregated and any remaining 'net gain' reduced by 4/9ths. This rule applies to both individuals and trust gains in respect of qualifying beneficiaries. The maximum cumulative 'net gain' qualifying for the reduction cannot exceed £1m.

Example

William sells his shares in a trading company in 2008/09 and realises a gain of £460,000. He has been a director of the company and has owned 45% of the ordinary shares of the company (which gave him 45% of the voting rights) for six years. He therefore qualifies for ER on the disposal of his shares.

On making a claim, William's gain is reduced by 4/9ths, resulting in a chargeable gain of £255,555. Assuming William has no other gains or losses, after deducting the annual exemption of £9,600 he has a chargeable gain of £245,955. This amount is taxed at 18%, giving CGT due of £44,271.

What about commercial property?

Commercial property has enjoyed a favourable status under taper relief rules and there has been a strong argument in favour of keeping property ownership in the hands of individuals rather than in a company.

The abolition of taper relief may mean a significant increase in the CGT bill on the disposal of commercial property. The introduction of ER will not do much to reduce the problem. The only situation in which ER will generally be available on the disposal of commercial property will be by means of an 'associated disposal'.

This means that the sale of assets used in a partnership or by a company but owned by an individual will only qualify for relief if the assets disposed of are 'associated' with the withdrawal of the individual from participation in the partnership or the company.

No ER will be available on the disposal of property which previously qualified for business asset taper because the property was let to another trader or an unconnected trading company.

ER – transitional rules

A number of individuals made gains prior to 6 April 2008 and have deferred the gain until after 5 April 2008. ER may be available when the deferred gain eventually becomes chargeable after 5 April 2008 if the original sale of shares in a trading company, or the sale of an unincorporated business, would have met the conditions for ER if ER had been available at the time of the original sale.

The deferred gains eligible for relief are where:

- shares in a trading company were disposed of in exchange for loan notes in another company which are Qualifying Corporate Bonds (QCBs); and
- the gains made on shares in a trading company or on the disposal of an unincorporated business were reinvested in Enterprise Investment Scheme (EIS) shares or Venture Capital Trust shares.

Example

Nicola sold her trading business in June 2006 and realised a gain of £280,000. She invested this amount in qualifying EIS shares in August 2006 and the gain was deferred.

In October 2010 she sells her EIS shares and the deferred gain of £280,000 becomes chargeable.

If the gain on the sale of her business in 2006 would have qualified for ER if ER had been available at that time, then ER will be due. Nicola can claim ER against the deferred gain. This would reduce the deferred gain by 4/9ths, leaving a chargeable gain of £155,555.

If an individual had shares in a trading company which were disposed of in exchange for loan notes in another company which are not QCBs, there may be ER on the disposal of the loan notes after 5 April 2008. However, the loan notes would need to be issued by a trading company in which the individual owns at least 5% of the shares and voting rights in that company and the individual is an officer or employee of that company.

Be careful

Whilst the introduction of ER goes some way to mitigating the loss of taper and indexation relief, the Chancellor's plan for a simple tax system has evaporated.

Considerable care will be needed in planning to obtain the benefit of ER. There are a number of traps for the unwary. These include the following areas:

- The disposal of a property used by an unincorporated business may not qualify if it is not related to the disposal of the whole, or part, of the business. For example, the sale of some land by a farmer would not qualify for relief as neither the whole, nor a part, of a business has been sold. Rather, it is a business asset that has been sold.
- The disposal of shares in a trading company may not qualify for ER if the company has 'substantial' non-trading activities in, broadly, the year preceding the disposal of the shares. HMRC view 'substantial' as meaning 20% of the activities of the company.
- There is no relief on the disposal of an investment asset. For example, where a partner retires and personally owns the partnership property, ER is potentially available on the disposal of the property but not if it is an investment asset. If the property has been let at a market value rent to the partnership, ER will not be available on any gain arising on the disposal of the property. Relief would be available if the property had been let rent-free.

As ever, tax is not straight forward. If you would like to discuss ER in detail and how it might affect your business, please do get in touch.