

Entrepreneurs' Relief

In October 2007 the government announced some major changes to capital gains tax for individuals and trustees for 2008/09. These include, for disposals and held over gains arising on or after 6 April 2008, the double whammy that neither taper relief nor indexation allowance are available (even if assets were held before this date). The chargeable gain is liable to tax at the new rate of 18% (subject to the deduction of allowable losses, any other reliefs and the annual exemption).

A new relief

After business leaders voiced their objections to the abolition of taper relief, the Chancellor 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:

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

The new relief is similar to the old Retirement Relief, which some of you may remember and which was phased out with the introduction of taper relief. The rules for Retirement Relief required an individual to have been in business for a number of years but the new rules are designed to be simpler:

- there will be no minimum age limit; and
- relief will be available where the relevant conditions are met for a period of one year.

What qualifies for relief?

The relief will 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 owns broadly a 5% shareholding and has been an officer or employee of the company;
- assets used by a business or a company which has ceased;

- 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.

A trading business includes professions but only includes a property business if it is a 'furnished holiday lettings' business. Trading company will have the same meaning as currently applies 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.

The relief available

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 aggregated and any remaining 'net gain' reduced by 4/9ths, giving an effective rate of 10% (18% x 5/9ths). 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.

Transitional rules

A number of individuals have 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)
- the gains made on shares in a trading company or on the disposal of an unincorporated business were reinvested in Enterprise Investment Scheme shares or Venture Capital Trust shares.

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 voting rights in that company and the individual is an officer or employee of that company.

Care must be taken

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

Considerable care is needed in planning to obtain the benefit of ER. For example, 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. The disposal of shares in a trading company may not get any ER if the company has 'substantial' non-trading activities at the time of the disposal of the shares.

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.