

Briefing document

29 February 2008

Capital Gains Tax Reform Entrepreneurs' Relief

Introduction

HM Revenue & Customs has published draft legislation for the new Entrepreneurs' Relief that was first announced by the Chancellor on 24 January 2008, when draft legislation was released for the other reforms to capital gains tax (CGT).

The relief will operate alongside the other reforms to CGT and will take effect from 6 April 2008. It will allow the first £1 million of gains arising on certain disposals in 2008/09 or later years to be charged to CGT at an effective rate of 10%. This will have the effect of saving a maximum of £80,000 in tax once the new 18% flat rate of CGT has been introduced.

The new relief applies where:

- An individual makes a material disposal of business assets;
- There is a disposal of qualifying business assets held by certain qualifying trustees; and
- An associated disposal is made by an individual.

The holding period for owning the assets sold is only 12 months and the relief applies over the course of the individual's lifetime on a cumulative basis.

Please note that any comments made in this briefing note are from a tax perspective only and investment considerations relevant to your own individual circumstances will need to be taken into account.

The framework

- Entrepreneurs' Relief may be claimed by individuals and trustees who make qualifying disposals on or after 6 April 2008. Trustees wishing to make a claim must make it jointly with the qualifying beneficiary.
- The time limit for the claim is the second 31 January following the tax year in which the qualifying disposal is made. This is the normal time limit for amending a self-assessment tax return for that year.
- The first £1 million of gains that qualify for relief will be charged to CGT at an effective rate of 10%. Gains in excess of £1 million will be charged at the normal 18% rate.
- An individual will be able to make claims for relief on more than one occasion, up to a lifetime total of £1 million of gains.
- Assets must fulfil the qualifying criteria for the period of one year before the date of sale.
- Disposals prior to the 2008/09 tax year do not affect the lifetime limit (unless the gains are deferred and Entrepreneurs' Relief is claimed under the transitional provisions – see below).

Qualifying disposals

The following will qualify for Entrepreneurs' Relief:

- Gains on the disposals of the whole or part of a continuing business, carried on by an individual either on his own or in partnership for a period of one year to the date of the disposal;
- Gains on the disposals of assets used by a business undertaken by a sole trader, or by partners, which has now come to an end provided that they were used as business assets at the time of cessation. There is a further requirement that the individual must have held an interest in the business throughout the period of a year prior to his or her involvement coming to an end. In addition, the disposal itself must take place within three years of that date.
- Gains on disposals of shares or securities in a trading company, or the holding company of a trading group, provided that during the period of one year ending with the date of the disposal the individual making the disposal:
 - (i) has been an officer or employee of the company, or of a company in the same group of companies.
and
 - (ii) owns at least 5% of the ordinary share capital of the company which enables the individual to exercise at least 5% of the voting rights in that company.

The rules provide that relief will still be available where the company has, within the three years immediately preceding the disposal, ceased to be either a trading company or a member of a trading group, provided the rules at (i) and (ii) were satisfied throughout the period of one year immediately preceding the cessation.

- Gains made by individuals in relation to assets used by a business undertaken by a partnership in which the individual was involved or a trading company or group where he or she satisfied the share ownership tests set out above. This form of 'associated disposal' relief only applies where the individual disposes of all or part of his interest in the assets of a partnership or of shares in or securities of a company which qualify for relief in their own right. This has to be part of a process of withdrawing from involvement with the partnership business or that of the trading company or group concerned.
- Gains made by trustees on the disposal of trust assets which are used in a business. In order for the trustees to qualify for the relief, a beneficiary of the trust with an absolute right to receive the trust's income (an interest in possession) relating to those assets must be involved in carrying on the business in question, personally or as a partner. Where shares in a qualifying trading company or group are held, such a beneficiary must qualify as an officer or employee of the company in question and the voting test relating to the shares listed above must also be satisfied.

In the case of shares, all of these requirements must be satisfied throughout a period of one year ending within the three years up to the date of the disposal. Where a business is being undertaken, the settlement's business assets must be used for the purposes of the trade carried on by the qualifying beneficiary throughout a period of one year ending within the three years up to the date of the disposal. In addition, the beneficiary must cease to carry on the business at some time during that three year period.

Some important features

- The amount of Entrepreneurs' Relief does not vary with the period of the individual's involvement with the business and there is no minimum age limit for Entrepreneurs' Relief.
- It is possible to be a part time employee and still qualify for relief as there are no set rules which state how many hours an officer or an employee has to work in order to qualify.
- Whilst the £1 million limit is described as a lifetime limit, it does not mean that disposals made before the start of the tax year 2008-09 will affect the availability of relief, unless the gains are deferred and Entrepreneurs' Relief is claimed under the transitional provisions set out in the draft legislation.

- The transitional rules allow claims for Entrepreneurs' Relief where an individual sold his company for shares or loan notes before 6 April 2008 and then disposes of these shares/loan notes afterwards. The broad effect is that relief may be claimed in respect of gains coming into charge if the gain on the disposal of the old asset would have qualified for Entrepreneurs' Relief, had it been available at that time. However, relief will only be available to the person who made the exchange, so for example it will be denied where there has been a transfer from one spouse to another. In some cases an election is required.
- Relief can also apply where the proceeds of a qualifying sale were invested in EIS shares and those deferred gains come back into charge on the sale of those shares after 5 April 2008.
- An important drawback is that there is no aggregation of spousal ownership, so if one spouse owns 3% of the ordinary voting rights of a qualifying trading company and the other owns 4%, neither of them will qualify for the relief.
- Investment companies will not qualify for the relief, only trading companies and holding companies of a trading group. These have the same definition as under the old taper relief rules. Consequently, the disposal of a let property or commercial property letting business will not qualify but the disposal of furnished holiday lettings will.
- In order to qualify for relief in respect of a continuing business, a gain must arise on the disposal of the whole or part of the business carried on by the claimant throughout the period of one year up to the time of the disposal. Mere disposal of an asset used for the purposes of a continuing business, without there being a disposal of all or part of the business, does not qualify.
- If a shareholder in a private company sells shares qualifying for relief in exchange for shares or loan notes in another company which may not qualify upon sale or redemption, it is possible to disapply the roll-over of the gain so that Entrepreneurs' Relief can be applied. If the gain is rolled-over Entrepreneurs' Relief will not be available later unless the new shares or securities qualify themselves.
- A sole trader taking on a partner can claim Entrepreneurs' Relief on any disposals of interest in the business assets which he contributes to the partnership. The relief will also be available to partners on any future disposals from the partnership.

Should I be doing anything?

The sale of any asset prior to 6 April 2008 will not form part of the £1 million cumulative lifetime allowance. If you own an asset that qualifies for the maximum business asset taper relief i.e. the gain is chargeable at an effective rate of CGT at 10%, then you may want to consider a disposal pre 6 April 2008 to take advantage of the business asset taper relief position of the asset and to preserve the lifetime allowance available.

You must note that a disposal after 6 April 2008 will not necessarily qualify for Entrepreneurs' Relief if the asset currently qualifies for business asset taper relief, as the conditions for these two reliefs are not the same.

Assets which have an element of deferred gains will need to be reviewed to confirm whether Entrepreneurs' Relief will be available on the eventual crystallisation of the deferred gain. These include deferred gains in respect of qualifying/non-qualifying loan notes, and EIS investments.

Find out more...

To find out more about any aspect of the above, please discuss with your usual Deloitte contact who will be happy to help and can provide you with access to Deloitte's network of tax specialists.

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