

CAPITAL GAINS TAX REFORM 2008

The Chancellor recently announced sweeping changes to the taxation of capital gains made by individuals and trustees. Capital gains realised by companies are not affected.

Taper relief which in recent years has meant an effective rate of tax of 10% on the disposal of Business assets will be abolished from 5th April 2008. Indexation relief, which avoids tax on inflationary gains, is also abolished. Instead all chargeable gains (after deducting losses and annual exemptions) will be taxed at 18%.

In practical terms this means that individuals disposing of business assets will see their tax liability increase from 10% to 18%, while those selling investment assets could see their tax liability cut by more than 50%.

To alleviate the tax burden on individuals selling their own business a new Entrepreneurs relief is to be introduced, whereby the first £1m of lifetime gains will be subject to a 10% tax charge.

Entrepreneurs Relief

The relief will be available in respect of:

- * Gains made on the disposal of all / part of a business;
- * Gains made on the disposal of assets (within 3 years of the business ceasing to trade), by certain individuals involved in the running of the business.

Assets qualifying for the new relief will include:

- * A trading business carried on by an individual or partnership.
- * Shares in a trading company provided that the selling shareholder has been an officer or an employee of the company and has owned at least 5% of the share capital.

The relief will not apply to investment businesses, such as property letting.

Associated Disposals

Where a person qualifies for relief on a share or partnership disposal, relief is also available in respect of an associated disposal.

For example, Person A sells their 50% shareholding in Company A and their property which is let to the company to trade from.

The relief for associated disposals will be restricted if the asset was not wholly in business use throughout its ownership. The disposal must be within a year of the disposal of the shares or business.

If full market rent has been charged to the partnership or the company there will be a restriction on the entrepreneurs relief on the associated disposal. The relief is restricted to the percentage of total market rent for ownership period less the rent charged/ total market rent.

The relief which is similar to the old 'retirement relief' is clearly targeted at business owners. There will be an effective 10% CGT rate on the disposal of one or more businesses by individuals and trustees up to a lifetime ceiling of £1m. Thereafter gains will be taxed at 18%.

There is no minimum age limit for entrepreneur's relief and the relief will be available where the relevant conditions are met for a period of one year.

The relief works by reducing the gain by 4/9ths – i.e. $5/9 \times 18\% = 10\%$. The £1million limit operates by allowing an individual to claim relief on gains which qualify for the new relief on many occasions up to the limit.

The relief will be restricted where the asset was not wholly in business use throughout the period of ownership.

To qualify for Entrepreneurs Relief there must be a material disposal of your interest in the business. Relief will not be available if you sell shares in your company and retain a significant holding.

What is meant by part disposal has not been defined, and it is therefore likely to be the subject of future litigation. The Revenue will, in all probability, use the findings in the *McGregor v Adcock* case to disallow claims for relief on the disposal of business assets, where there has been no significant reduction in the overall trading activities of the business.

The sale of ones farm is likely to qualify for relief but the gain arising from the sale of individual sites is unlikely to qualify and will be taxed at 18%. However what about the farmer who owns three farms but only sells one. The availability of Entrepreneurs Relief on the first sale will depend on whether the business as a whole has been affected by the sale. For example if he is selling his diary herd and continuing on a reduced scale as a beef farmer relief may well be available.

Similarly a trader owns 2 shops in two different towns decides to sell one shop may or may not qualify for relief. If the shops are two entirely separate businesses, connected only by common ownership, then it is likely to qualify. If the shops are just two branches of the same trade however, the trade then being continued from the remaining shop, then the relief is unlikely to be available.