

The new capital gains tax entrepreneurs' relief

With the abolition of the capital gains tax taper relief regime with effect from 6 April 2008, and with it the end of the favourable effective rate of tax for business assets, the Government was persuaded after some outcry that business assets deserved more beneficial treatment under the new capital gains tax regime.

It will be recalled that the new regime has swept away all the complexities of the previous taper relief regime as well as indexation relief and some other detailed rules, and the rate of capital gains tax has been reduced to a flat 18% for all individual taxpayers and trustees. The 18% rate is considerably higher than that which applied under taper relief and to compensate 'entrepreneurs' relief' has been introduced in the new rules. The broad effect of this relief is to allow a tax rate of 10% for certain business assets but there are many limitations and the new relief should therefore no way be regarded as an adequate replacement for the previous business asset taper relief regime.

Business assets, for the purposes of entrepreneurs' relief, fall into two broad categories, the first being for certain shares or securities of a company and a second being for assets, including good will, used for the purposes of the trade profession or vocation carried on by an individual or a partnership.

As regards shares and securities, an important limitation not applicable under the taper regime is that the company concerned must be the individual's "personal company" and the individual must also be an officer or employee of the company. These conditions apply for the one year period ending with the date of disposal. A "personal company" is defined as one in which at least 5% of the ordinary share capital is held by the individual and at least 5% of the voting rights in the company are exercisable by the individual by virtue of that holding. This means that any individual holding less than 5% of the share capital in a company cannot benefit from entrepreneurs' relief in respect of a gain realised on the disposal of that holding. The result is therefore that shareholdings above the 5% test may continue to have beneficial capital gains tax treatment, but very small shareholdings, commonly held by the less wealthy, no longer have a favourable capital gains tax treatment as they did under taper relief.

The disposal by an individual of the whole or part of a business will potentially qualify for entrepreneurs' relief, as well as the disposal of any assets previously used in such a business so long as the disposal of those assets takes place within 3 years of the time when the business ceased to be carried on. It follows therefore that the disposal of assets used in business, but without a disposal of the business itself, will not qualify for entrepreneurs' relief. Nor will a disposal of assets made more than 3 years after the cessation of business.

There is also one further important test relating to the disposal of an asset used for the purposes of a business; this is that if rent has been paid by the business

for the use of the asset, the amount of relief available will be affected. This will not of course apply to a sole trader, but it is an important test in respect of assets held by a partner individually and used for the purposes of the partnership business, or an asset owned personally by the principal shareholder of a family company. In either case, if the partnership or the company has paid full market rent for the use of the asset, this prevents a claim for entrepreneurs' relief in respect of that asset. If the rent paid was less than full market rent, the relief available on the asset will be proportionately reduced.

Properties used by family companies are frequently held by the principal shareholder personally; this is for a number of reasons not the least of which is that holding the property within the company can give rise to double capital gains tax liabilities on disposal, once in the company itself and then secondly by appreciation in the value of the shares. In the past it has also been sensible planning for the company to pay rent for the use of the asset because this is a mechanism for withdrawing funds from the company free of liability to national insurance contributions. Under the latest changes to the capital gains tax regime, it will now transpire that the payment of rent in the past will adversely affect the availability of entrepreneurs' relief on the disposal of the property.

Entrepreneurs' relief is limited to gains of up to £1million, and this is a lifetime allowance available to each individual. Once again therefore it will be seen that the problem about past rent payments is unlikely to affect the very wealthy, who may be able to make full use of the £1million allowance against other assets, whereas less wealthy tax payers may find that entrepreneurs' relief will be restricted when they retire and sell up their business arrangements because rent has been paid for some of the assets used in the business.

The rule about payment of rent does not however apply for any period after the business ceases. Accordingly if an asset has been used rent free by an individual's company, and he then sells the shares in the company and rents the asset to the purchaser after the sale, this in itself will not have any impact on entrepreneurs' relief for the asset. It would however still be necessary for the asset to be disposed of in three years of the sale of shares.

Those selling shares in a private company frequently receive some shares or loan notes in the purchaser company in exchange for part of the existing shareholding. Where shares or non qualifying corporate bonds are received in exchange for the existing shareholding, it is important to appreciate that it is quite possible for this to mean the loss of entrepreneurs' relief in respect of the accrued gains to date in the that shareholding. The tests for the entrepreneur's relief will be applied in due course to the shares and loan notes received in exchange for the original shareholding when they are disposed of; it is quite possible that in many cases the tests will not be satisfied. It may therefore be better for qualifying corporate bonds to be received in exchange for the existing shares, as the test for the availability for entrepreneurs' relief will be applied at

the time of the exchange of the existing shares for qualifying corporate bonds, even though the gain is not actually chargeable until the disposal of the bonds.

There are many other quirks with this new capital gains tax relief and tax payers holding shares or other assets which previously qualified for business asset taper relief should seek advice at an early stage to establish whether any alterations to existing arrangements are advisable under the new regime.

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