



Capital Gains Tax - the draft legislation and the new "entrepreneurs' relief"

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Following the cries of protest and a spate of lobbying by the business community and tax professionals the Chancellor has finally unveiled his revised plans for the changes to the capital gains tax rules which were originally announced last October. Whilst he confirmed the introduction of an 18% flat rate of CGT from 6 April 2008, Alastair Darling softened the blow somewhat by announcing the introduction of a new "entrepreneurs' relief".

Although the entrepreneurs' relief will assist many business owners there will still be cases where a disposal before 6 April 2008 may be advisable particularly if a disposal was being planned in the near future anyway.

The main changes from 6 April 2008

- 18% flat rate of CGT (but less if entrepreneurs' relief available)
- abolition of taper relief
- abolition of the indexation allowance
- more technical changes (abolition of the "kink test" which is only relevant for assets held on 31 March 1982, the abolition of halving relief and the simplification of the share pooling rules).

The CGT annual exemption remains as will main residence relief, rollover and holdover reliefs and EIS reliefs. Capital losses will still be available to offset against capital gains.

Entrepreneurs' relief - how it will work

The draft legislation on the new relief is yet to be published, but what we know so far is that those who qualify will pay 10% CGT on the first £1m of capital gain. This is a lifetime allowance so it can cover more than one disposal.

Gains over £1m will be subject to CGT at the normal 18% rate.

The relief is expected to be available in respect of:

- a disposal of the whole or part of a business
- a disposal of shares or securities in a trading company or

the holding company of a trading group (defined as for taper relief) but with a requirement for a 5% holding and to be a working officer or employee

- an associated disposal (i.e. a disposal of assets held personally but used by the company)
- disposals of assets within 3 years of cessation of business as a going concern.

These four categories are similar to those used in the old retirement relief rules. Although many of the awkward restrictions on retirement relief are not reproduced we may see problems that affected retirement relief re-emerging - such as whether a disposal is merely of an asset used in the business rather than part of the business (eg a farmer sells half his land - is it merely a sale of an asset on which entrepreneurs' relief is unavailable?).

The winners and losers?

The entrepreneurs' relief will help some but there will remain the following losers:

Losers

- Those who currently qualify for business taper but will not qualify for entrepreneurs' relief, e.g:
 - landlords of trading assets
 - holders of AIM shares
 - trustees of discretionary trusts
 - trustees of some life interest trusts
 - shareholders in trading companies who are not officers or employees
- Those for whom indexation is currently very valuable - a key example being farmers and landowners who have owned their land for many years
- Those for whom the kink test or halving relief are of value
- Non UK domiciliaries - the tax rules for people who are non UK domiciled have changed for the worse,

particularly where assets are held in offshore structures. See our separate briefing on this topic.

... and the winners?

- Those who own assets on which the current rate of CGT is more than 18% (eg owners of non business assets and second homes where currently the rate would be between 24% and 40%)
- UK resident domiciliaries (and, shortly, non-domiciliaries) who receive capital payments from offshore trusts for whom the maximum rate of tax decreases from 64% to 28.8%.

Planning points

Most of the points set out in our October 2007 briefing remain relevant. The key ones are:

- Whilst the hoped for ability to make a rebasing election has not been introduced those who would pay less than 18% tax before 6 April should consider ways to trigger the tax now. The tax would normally be payable at the end of January 2009. We are looking at ways in which it may be possible to further defer the date on which the tax falls due
- Where the tax rate will be lower after 6 April, but a sale is planned now either delay exchange of contracts or use a conditional contract to defer the tax point of the contract. For some rolling the gains into assets now that can be sold after 6 April may be an option
- Where the indexation allowance is valuable consider disposals to capture the indexation (eg from one spouse to another or a gift to a connected person). This is of particular relevance to landowners
- Even those who qualify for the new entrepreneurs' relief should consider making an early disposal, if indexation is valuable to them
- Likewise, a disposal now will not count towards the £1m limit
- Trustees should review their position as there will be many instances in which they will not qualify for the new entrepreneurs' relief
- Where entrepreneurs' relief is available, consider splitting the assets between husband and wife, to double up the £1m relief.

Conclusion

The new entrepreneurs' relief will be good news for almost all holders of investment assets but for those who have qualified for business taper relief up to now, or those to whom indexation is valuable, there may be opportunities to minimise CGT by taking action before 6 April 2008.

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