



More changes to capital gains tax

On 24 January 2008, the Chancellor announced significant concessions to the changes to the UK capital gains tax (CGT) regime, which were proposed in his Pre-Budget Statement last October. The original proposals would have seen the effective rate of CGT nearly double from 10% to 18% for many taxpayers from 5 April 2008. A new relief – entrepreneurs' relief – is to be introduced. It will reduce or remove the impact of this increase in tax for those smaller businesses that were particularly affected by the Pre-Budget Statement.

Original changes

The changes proposed in the Pre-Budget Statement were:

- all capital gains made on or after 6 April 2008 will be taxed at a flat rate of 18%. This is irrespective of the marginal income tax rate of the taxpayer concerned. This rate will apply to individuals and trusts;
- the current system of taper relief will be abolished;
- the system of indexation allowance, which was in place before the introduction of the taper relief rules, will also be abolished. In addition, certain other rules will be amended or abolished including:
 - compulsory use of market value at 31 March 1982 for assets held at that date;
 - abolition of 'halving relief'; and
 - simplification of share identification rules.

The annual exemption for capital gains tax, i.e. the amount that can be earned before paying capital gains tax, will remain in place.

Entrepreneurs' relief – the basics

The new entrepreneurs' relief will apply for gains that arise on or after 6 April 2008 on:

- disposals of all or part of a trading business; and
- certain disposals of shares in trading companies.

The first £1 million of gains that qualify for the relief will be subject to CGT at a reduced rate of 10%. The £1 million limit

will be a lifetime limit. Any gains that do not qualify or that exceed the limit will be charged at the new rate of 18%.

HMRC has indicated that the new relief will be relatively simple. The main condition announced so far is a minimum ownership period of one year.

The detail

The relief will apply to gains arising on disposals of the whole or part of a trading business (including professions and vocations, but not including a property

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letting business other than furnished holiday lettings) that is carried on by the individual, either alone or in partnership or on gains on assets formerly used in the business and disposed of within 3 years of its cessation.

The relief will also apply to gains on disposals of shares (and securities) in a

trading company (or the holding company of a trading group) provided that the individual making the disposal:

- has been an officer or employee of the company, or of a company in the same group of companies; and
- owns at least 5% of the ordinary share capital of the company and that holding enables the individual to exercise at least 5% of the voting rights in that company.

Rules will also be introduced to include disposals associated with qualifying share sales of assets used for the purposes of the company's business. A similar rule will apply for partners who own assets used by the partnership of which he or she is a member.



New entrepreneurs' relief to be introduced to CGT regime.



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The relief will also be available for trustees where a beneficiary of the trust is either carrying on a business in which he or she has an interest in possession (either as a sole trader or as a partner) or where the beneficiary is a qualifying officer or employee of the company whose shares are held by the trustees. In the case of trusts, the £1 million limit will be applied to the trustees and beneficiary jointly to remove opportunities for using trusts to avoid tax in this area.

Draft legislation on the new entrepreneurs' relief is yet to be published.

Companies liable to corporation tax are not affected by any of the proposed changes.

Comments

This concession is extremely welcome but comes as no great surprise. The level of adverse comment and publicity that followed the changes in the 2007 Pre-Budget Statement made it almost inevitable that some form of relief would be introduced.

One area that does not appear to have been addressed is the position of employees

who own shares in their employer. Most employees will not meet the minimum shareholding requirements outlined above and so will bear 18% tax on any gains arising after 5 April 2008.

The proposals will also impose additional compliance burdens in keeping track of lifetime gains. It is unfortunate that what was purported to be a change designed to

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simplify the UK tax rules has resulted in some degree of additional complexity. This was to some extent a result of the manner in which the autumn changes were introduced with no opportunity for consultation with business in advance. We hope that in future the Government will attempt to avoid repeating this

approach but it remains to be seen.

At the same time as announcing the introduction of the entrepreneurs' relief, the Treasury has also published the draft legislation to effect the changes announced at the Pre-Budget Statement. These will be subject to further commentary once they have been fully analysed.

If you would like further information on the proposals, please contact your usual Scott-Moncrieff tax adviser.



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