

### Key Points

- The Chancellor of the Exchequer recently announced the introduction of a new capital gains tax relief, targeted at the owners of small businesses (entrepreneurs), which will mean a 10% tax rate for up to the first £1million of lifetime capital gains. It will apply from 6<sup>th</sup> April 2008, when the other capital gains tax reforms proposed in last October's Pre-Budget Report come into effect.
- The new relief is the Government's response to the concerns expressed by and on behalf of small businesses that the introduction of a flat rate of capital gains tax of 18% would mean a substantial increase in the rate paid by the majority of small business owners when selling their businesses.
- During his statement, the Chancellor made brief reference to the representations made by the life insurance industry to the proposed changes to capital gains tax, and indicated that the issues raised were complex and representations were still being considered.

### Introduction

The Pre-Budget Report contained proposals to reform and simplify the current capital gains tax (CGT) regime for disposals made on or after 6th April 2008. The proposals will affect individuals, trustees and personal representatives who have a gain which is subject to CGT and include:

- A single rate of CGT at 18%
- The withdrawal of taper relief
- The withdrawal of indexation allowance

These proposals have attracted much attention, and concern has been expressed by and on behalf of small business owners in particular who, with the removal of business assets taper relief and the imposition of a flat rate, would, in many cases, have faced a substantial increase in their CGT liability on disposal of their businesses after 5<sup>th</sup> April 2008.

In response to these concerns, and to demonstrate that Government's continuing commitment to supporting small business and enterprise, the Chancellor of the Exchequer recently announced the introduction of a new "Entrepreneurs Relief". This will deliver an effective 10% tax rate for the first £1million of lifetime gains on qualifying business assets. Gains in excess of £1million will be charged at the 18% rate.

### Entrepreneurs' Relief

Entrepreneurs' Relief is targeted at the owners of small businesses, and will apply when they sell their business. The relief will also be available to employees and company directors who have a material stake in a qualifying company.

Individuals will be able to claim relief for gains made on more than one occasion up to a cumulative total of £1million.

According to HM Revenue & Customs (HMRC)'s guidance notes the new relief will apply against:

- capital gains made when an individual disposes of all or part of an unincorporated business (e.g. a sole trader), or partnership interest;
- capital gains made when an individual disposes of assets following the cessation of a business;
- capital gains made by individuals on the disposal of shares (and securities) in a trading company (or holding company of a trading group), provided that the individual making the disposal:
  - has been an officer or employee of the company or of one in the same group of companies, and
  - owns at least 5% of the ordinary share capital of the company, and is entitled to exercise at least 5% of the voting rights in that company.

A business in terms of this relief will be any trade, profession or vocation, excluding property letting, although furnished holiday lettings will be regarded as a trade for the purposes of the relief.

Although business assets taper relief will no longer be available from 6th April 2008, Entrepreneurs' Relief is dependent on there being a continuing qualifying business. It will therefore be essential to ensure that the business is a qualifying trade, profession or vocation (or furnished holiday let), which means that the 20% test continues to apply

after 6th April 2008. The test measures non-trading activities, which must not be substantial (i.e. account for more than 20% of turnover, assets or profits). This means that businesses will have to continue to watch the size of their cash balances and investment activities.

Draft legislation for Entrepreneurs' Relief is expected shortly, when more details will emerge. Clarification is required in areas such as whether there will be any transitional provisions, and if the £1million relief is available to both husbands and wives/registered civil partners who are in business together.

## **Conclusion**

Entrepreneurs' Relief will be welcomed by the majority of small business owners, who appear to have successfully lobbied to mitigate the effects of the proposed changes to CGT for them.

The changes to CGT have generated a great deal of debate, not least within the life insurance industry where work is continuing with the Association of British Insurers (ABI) to lobby HM Treasury with a view to negotiating a "level playing field" as to the tax consequences for clients holding collectives and/or investment bonds.

It is understood that the Chancellor is due to meet members of the ABI Board on 13<sup>th</sup> February 2008.

We will continue to closely monitor the situation and will communicate any further developments and analysis as they arise.