



Entrepreneur's Relief provides mixed relief for businesses

Few owner managed businesses stand to benefit from the Government's latest U-turn on Capital Gains Tax.

The new "Entrepreneur's Relief", provides a special tax rate of 10% on the sale of businesses, or interests in a business, up to a limit of £1m. Capital gains over the £1m limit will be charged at the new Capital Gains Tax flat rate of 18%, due to be introduced in April.

Although this appears to be good news to anyone seeking to sell a business, or their interest in it, it only really represents a partial return to the regime that is already in place.

Currently businesses qualify for Taper Relief, reducing the CGT rate to a maximum of 10%, providing it has been held for two years or more. Under the new regulations, taxpayers will only have to own the business for one year to qualify for the relief, which will also apply to trading assets, as long as they are sold complete with the business, or within three years from the cessation of trade.

The new relief will be worth £80,000 to an individual, if they use the full allowance over the course of their lifetime. But the problem is that it only applies to the sale of whole businesses, including shares, or interests in a business. Importantly, it will not apply to disposals of individual business assets, like commercial buildings, if they are sold in isolation.

Under the current tax regime, individuals seeking to sell or gift business assets will qualify for Taper Relief and Indexation Allowance, reducing the tax

rate to a maximum of 10%, but from April, these assets will be chargeable at the new rate of 18% with no allowance for inflation, which will give a significant increase in the tax payable.

Although some people are acclaiming Alistair Darling's latest U-turn as a victory for small businesses, the reality is that only those who are selling up and getting out will benefit.

Even those seeking to dispose of entire businesses should consider the loss of Indexation Allowance from 6 April, as they may still be better off taking action before the new rules come in.

There are ways to crystallise capital gains before April, to make the most of Taper Relief and Indexation Allowance. There may also be an opportunity for people to split up their existing business to allow for separate disposals in the coming years. However, as always, the devil is in the detail so it is essential to take professional advice and act now, before it is too late.

Have you held land and/or property in your own name, dating back as far as or even before 1982?

For those with long-term land and/or property holdings, the loss of Indexation Allowance will significantly increase the likely tax liability on any future disposal of such assets. The combination of Indexation Allowance and Business Asset Taper Relief often means that owners under the existing regime pay little tax when they sell small to medium value parcels of land or property. Both Indexation Allowance and Taper Relief are about to be abolished, this may have a major impact

on future tax liabilities if no action is taken.

Have you held land and/or property for a long time that you are now considering passing down a generation?

For those who have held land dating to or before 1982, now may be the time to consider a gift to the next generation. By making a gift before 5 April 2008, and including a holdover claim, no Capital Gains Tax is payable now and any Indexation Allowance that would otherwise be lost on 6 April 2008 would be crystallised and locked in for the benefit of the next generation. If the transferee then subsequently sells the land, their base costs will incorporate Indexation Allowance Relief. However, please note that, if you hold on to land or property until death the land or property would automatically be rebased to the market value at the date of death. Provided the land or property attracts Inheritance Tax Relief, there may not be any Inheritance Tax liability either and this may provide a better alternative to making a lifetime gift.

Do you think you are going to sell commercial property or land used for trading purposes in the next 12-24 months?

The Chancellor's new Entrepreneur Relief for those selling businesses or business interests only applies where a whole business is disposed of by that particular individual. Simply selling an asset which has been used as part of a trade will not allow that gain to be taxed at the lower rate of 10% but would normally be taxed at 18%.

It is virtually impossible to envisage being able to market and find a buyer for property to the point that contracts have exchanged by 5 April 2008. An alternative is to consider transferring the asset into a Settlor Interested Trust to crystallise the gain. Whilst Capital Gains Tax will be payable on 31 January 2009 on a transfer into a Settlor Interested Trust which takes place prior to 5 April 2008, you will at least be able to lock in indexation relief, Taper Relief and indeed another block of annual exemptions. You are then left to dispose of the asset without being forced to take the first available deal. The numbers need to be run to see if this is an effective strategy.

Did you think you wanted to incorporate and take advantage of goodwill transfers?

Many businesses have incorporated over the last few years and have often quantified a value for goodwill transferred from their host business into the new limited company. That transfer has been possible

at reasonable cost from a tax perspective by claiming Business Asset Taper Relief, a relief that will no longer be available after 5 April 2008. Consider incorporation prior to 5 April 2008 in suitable cases professional advice must be taken as there are a number of other important factors to take into account.

Do you want to gift or liquidate the shares you have held in the company which you have owned for a long period of time?

Business Asset Taper Relief and perhaps more importantly Indexation Allowance also applies to certain shareholdings of longstanding. For example, if you trade using a limited company and that company has significant value (especially if it holds property assets itself) and you have held those shares prior to 1998 or even as far back as 1982 or earlier, the loss of Indexation Relief on the shares may significantly increase your tax liability on any liquidation (perhaps to extract cash following a sale) that takes place after 5 April 2008 irrespective of whether or not you qualify for the new Entrepreneur Relief. The same principal also applies to gifting shares to a family member who will not be able to benefit from the donor's Indexation Allowance if that gift takes place after 5 April 2008.

Have you paid Capital Gains Tax at the higher rates for non business assets in the last three years? There might be an opportunity!

Where tax payers have paid tax at higher rates, perhaps as a result of selling an asset that only qualified as an investment rather than one used within the business, there may be an opportunity to mitigate such tax. One possibility is to consider Enterprise Investment Scheme Relief whereby capital gains on an original disposal can be deferred into an EIS qualifying investment. Only when that investment is sold will the gain re-crystallise. Tax payers have three years from the date of the original disposal to make the EIS reinvestment and the advantage here is that the deferral may come from a sale that was taxed at rates of up to 40% whereas the release of the deferred gain on the sale of the EIS investment will take place in a post 5 April 2008 regime where the maximum Capital Gains Tax rate is 18%. This could produce tax savings up to 22% on the gain which is significant.

EIS relief is a specialist area but one that is increasingly commonly used in these circumstances. Seek professional advice on this matter and a combination of Old Mill Accountancy LLP and Old Mill Financial Services LLP are in a prime position to give you the robust advice that you need.

