

Article for New Model Adviser

Q and A Tax

Relief for entrepreneurs?

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The phone rang as Ben was looking out of the window and watching a kingfisher perched on a branch above the river.

“Ben, hi, it’s Steve.”

“Hi Steve, how are you? We haven’t spoken for ages,” replied Ben. Steve was one of Ben’s oldest clients who had jumped off the corporate treadmill 6 or 7 years ago and had been involved in several businesses since. “How’s business, any new ventures?”

“Well, Ben, that’s sort of what I wanted to talk to you about,” said Steve. “I’ve been reading the papers over the last few months and every time I come across an article about capital gains tax, it seems to be saying something different to the last one! I have been reading about this entrepreneurs’ relief and am wondering how it will all affect me. Can you give me a quick run-down, please?”

“Yes, Steve, of course I can. But, as you’ve said, these proposals have met with a lot of resistance since they were announced in October’s Pre Budget Report, and it’s quite possible that they may change again on their way through Parliament and before they become law.”

“If only these politicians would come out into the real world”, said Steve, “they might then start to understand how much uncertainty their dithering causes for people in business, such as us!”

“You’re right Steve, but this just seems to be the way things are done these days, and I guess we’ll just have to live with it for the time being. Anyway, as you’re probably aware, the proposal is for a flat rate of 18% capital gains tax to apply on disposals of assets from the 6th April this year and from that date, the indexation allowance and taper relief that can currently be claimed will no longer apply, although you will still benefit from the annual exemption. This 18% tax rate is seen to be a simplification and to be easier to understand by taxpayers...”

“It would be easier if we didn’t have to pay it at all,” interrupted Steve.

“I know, and that was proposed by the Major government, but I doubt any political party are brave enough to abolish CGT – it would be seen to be favouring the rich”, replied Ben.

“Well, we can always live in hope, true simplification of taxes would be to have flat rate that applied to all, or even better, fewer taxes!”

“I agree Steve, and some Eastern European countries have adopted flat taxes, but that is something to discuss another day. Now, as I was saying, the original proposal was for a flat rate of 18% to apply to all disposals, but this was seen by the business community to be a way of hiking CGT rates by 80% for business owners, or even 260% if he is a basic rate taxpayer, who would currently be paying 5% tax if he qualifies for full business asset taper relief. So, eventually, the government dusted off the old retirement relief rules, that were phased out about 5 years ago and repackaged them into entrepreneurs’ relief. Until very recently, there were scant details about how this would work, but our current understanding is that business people, such as yourself, can claim this entrepreneurs’ relief on disposal, or part disposal of business assets from 6 April 2008.”

Yes, Ben, that’s what I understood, and we pay just 10% tax on these disposals, don’t we?”

“Well, not quite, although you do for all practical purposes, but the government didn’t want to be seen backing down on this 18% tax rate, so what they have said, is that for gains where entrepreneurs’ relief is claimed, the gain will be reduced by 4/9s but taxed at 18%. This does give an effective rate of tax of 10% on the full taxable gain.”

“Wow, some simplification,” breathed Steve.

“Yes,” laughed Ben, “there is also a maximum amount of gains that can be set against a claim for the relief of £1 million over your lifetime, whether these gains are realised in a single disposal or over multiple disposals of qualifying assets over a number of years. Once you exceed the £1 million limit, all excess gains will be taxed at 18% or whatever rate is prevailing at the date of disposal.”

“Well, the £1 million limit sounds quite generous, doesn’t it,” said Steve.

“It does today,” replied Ben, “but I haven’t seen anything yet saying whether this limit will increase in line with inflation or some other index, so, over the years to come, its value could be severely eroded by fiscal drag if it does not keep pace with inflation.”

“Ben, you also mentioned “qualifying assets”, what are these?”

“Well, broadly speaking, Steve, the relief can be claimed on disposal of all or part of a trading business, or on disposal of business assets on cessation of a business, by certain people involved in the business. These people should be officers or employees of the business and should have controlled at least 5% of the business for at least 12 months before the disposal, so, for a limited company, you would need to hold at least 5% of the ordinary share capital of the company and have at least 5% of the voting rights during this period. This rule effectively disqualifies the vast majority of employees of medium to large businesses from being able to claim the relief.”

“That seems a bit unfair if they can get business asset taper relief at the moment on shareholdings in their employers, doesn’t it?” said Steve.

“It does, but these proposals seem to have largely ignored such employees,” agreed Ben.

“OK, thanks Ben, that has been really useful, but I have a meeting starting in a few minutes, so will have to go. Before I do, one last question, as this only applies from 6 April, the business assets I have sold over the last couple of years won’t be affected will they?”

“As long as you have received the cash and not deferred the gain you should be OK, but when that recruitment business you’d bought into was taken over a couple of years ago, didn’t you take some of the proceeds as loan notes to defer the gain?”

“I did and should be able to start redeeming these in the next 18 months or so” replied Steve.

“Well, Steve, as long as these loan notes are qualifying corporate bonds, you should be able to claim entrepreneurs’ relief, but the gains will start eating into your £1 million lifetime limit.”

“But isn’t that then retrospective? I sold those shares 3 years ago!” said Steve.

“It may be to you and me, but not to the legislators”, said Ben, “look, I know you’re pushed for time now, but why don’t we get together in the next few weeks and discuss this properly, especially as some of the detail may become clearer between now and then. I’ll get Jo to give you a call and set up a meeting.”

“Sounds good, and thanks again Ben. I’m looking forward to it. Bye for now.”

“Bye, Steve”.

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