Article for New Model Adviser

Q and A Tax

Relief for entrepreneurs? – Part 2

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695 Words

The sting in the tail!

Following their recent meeting, Steve has called Ben to ask for a simple comparison between the pre- and post 5 April 2008 CGT regimes.

Steve and a business partner, Mark, have built up a small web design business over the last 5 years, but have been approached by a competitor with a view to purchasing the business. Steve and Mark own 50% of the shares each and are interested in a sale – they believe that this market is becoming increasingly saturated and they would have to invest a significant amount of time and money to grow the business at a time when other business ventures are showing better potential for returns.

Steve is also concerned about the current economic prospects and thinks that it is possible that some of his customers, who are small businesses themselves, could be driven out of business if the economy lapses into recession. This would have an obvious detrimental effect on the web design business.

Steve has asked Ben to prepare an estimation of the capital gains tax liability that he and Mark would face if they sold the business in May 2008, but also, following their last conversation, that Ben also estimates the capital gains tax liability that would have applied had they sold the business during the 2007-08 tax year, as he has heard the Chancellor's claims that the introduction of entrepreneurs' relief will leave business owners disposing of assets in the same position as pre-6 April 2008.

The proceeds of the sale, after all expenses, are estimated to be £100,000. Steve and Mark acquired the shares in the company for £1,000 each when they established the business. Steve is a higher rate income tax payer and Mark, who is starting to wind down his business activities before he retires has taxable income in the region of £30,000 pa.

Ben has sat down with the Revenue's press releases on entrepreneurs' relief and started working through the examples for Steve and Mark. The examples assume that

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75% business asset taper relief was available for the disposal in 2007-2008 and that Steve and Mark are not realising any other capital gains (or losses).

1. Capital Gain – share sale in 2007/2008

	£
Value of (each) shareholding	50,000
Cost of shares	1,000

Capital gain	49,000
Less Business Asset Taper relief @ 75%	36,750

Chargeable gain	12,250
Less CGT Annual Exemption (2007-08)	9,200

Taxable gain	3,050

CGT @ 40% for Steve £ 1,220

CGT @ 20% for Mark £ 610

Capital Gain – share sale in 2008-2009

	£
Value of (each) shareholding	50,000
Cost of shares	1,000

Capital gain	49,000
Less CGT Annual Exemption (2008-09)	9,600

Taxable gain	39,400

CGT @ 18% for Steve £ 7,092

CGT @ 18% for Mark £ 7,092

Alternatively, Steve and Mark could claim entrepreneurs' relief (as they are employees of the company and have each held over 5% of the trading company's shares and voting rights for at least 12 months). This reduces the capital gain to 5/9ths, therefore, the CGT calculation would change to:

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Capital gain	49,000
Reduce by entrepreneurs' relief to 5/9ths	27,222
Less CGT Annual Exemption	9,600

Taxable gain	17,622

CGT @ 18% for Steve £ 3,172

CGT @ 18% for Mark £ 3,172

Each gain of £49,000 would be set against Steve's and Mark's £1 million lifetime limits for entrepreneurs' relief.

So, despite the widely broadcast "equivalent 10% tax rate" produced by entrepreneurs' relief and the higher CGT annual exemption for 2008-09, Steve would face a 160% increase in his CGT liability and Mark an increase of 520% by deferring the disposal until after 5 April 2008! Ben realises that this increase in the tax liability, which may be largely unexpected by many taxpayers, is due to the different ways in which the CGT annual exemption is applied between the old and new regimes.

Ben sits back thankful that he'd bothered to sit down to do the calculations and not just assumed that tax liabilities wouldn't change by claiming entrepreneurs' relief. Looking out of the window, he sees that the kingfisher is back sitting on the branch above the river.

This scenario is fictional and is for illustrative purposes only. No responsibility will be accepted for any loss occasioned by a person acting or refraining from acting on the basis of this article. Relevant professional advice should be sought before taking any action.

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