

Private Capital Newsletter

Entrepreneur relief

In his Pre Budget Report of October 2007, the Chancellor surprised many by introducing a single rate of capital gains tax of 18% from 6 April 2008.

Some taxpayers would be better off, others would be worse off. Significantly, and not surprisingly, the latter lobbied the Chancellor for changes and he subsequently issued a Statement in January 2008 in which he introduced a significant new relief to be known as "entrepreneur relief" to come into effect on 6 April 2008.

Many of the "losers" from the introduction of the single rate of capital gains tax were farmers, owners of trading businesses or partners and shareholders in unquoted companies, who – prior to 5 April 2008 – qualified for business taper relief at the maximum rate of 75% and who would have seen their capital gains tax almost double after 5 April from 10% to 18%. The increase could often be proportionately greater than this once the elimination of indexation allowance was taken into account.

The Chancellor has gone some way to restoring their position with the introduction of "entrepreneur relief".

Certain disposals after 6 April 2008 will now attract a capital gains tax rate of 10% rather than 18% – at least on the first £1m of gain. That £1m is calculated on a cumulative basis, ignoring any disposals prior to 6 April 2008. It is not £1m per year but £1m in total per taxpayer during the taxpayer's lifetime. Husband and wife are each entitled to £1m of relief provided that they each satisfy all the relevant conditions.

What then are the relevant conditions?

Briefly, they rely much upon the old "retirement relief" rules which were phased out in the late 1990s rather than



the "business taper relief" rules which they were designed to replace. Do not assume that because you would have qualified for business taper relief pre 6 April 2008 you will automatically qualify for entrepreneur relief after that date – the rules are much more restrictive!

To qualify for relief, the disposal must fall into one of the following categories:-

- The disposal of all or part of a business. You must have held the business for at least 12 months. It is not sufficient simply to dispose of a business asset; the disposal must be of all or part of a business. Often they will be the same – but not necessarily

– for example, a farmer disposing of one acre of land out of a holding of 1,000 acres might not qualify.

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- The disposal of an interest in assets which were used for business purposes, following the cessation of the business. Normally, the business must have been carried on for at least 12 months and the disposal must take place within 3 years of its ceasing.
- The disposal of shares in a trading company, provided that:-
 - you have held them for at least 12 months
 - you are an officer or employee of the company – not necessarily full time
 - you have at least 5% of both the ordinary share capital and the voting rights

In the usual way, there can be restrictions if some assets of the company are not used for business purposes.

Special rules allow trustees to claim relief, in certain cases, and extend the relief to other disposals associated with qualifying disposals.

Note also that the relief, even if all the conditions are met, is not given automatically. It must be claimed within the prescribed time period. The time limit for a claim for the tax year 2008/09 is 31 January 2011 – i.e. 22 months after the end of the tax year.

It is not necessary to retire and there is no upper or lower age limit.

In summary, this is a very significant and valuable relief for those who meet all the conditions. However, some taxpayers will still be worse off than before 6 April 2008, particularly those who had held their assets for several years prior to the abolition of indexation relief in 1998 – and, for the avoidance of doubt, indexation relief until 1998 has now been lost for ever! But at least the new relief is of some help.

Many of the conditions are factual, and there should be no doubt as to whether they have been satisfied or not. Others are more subjective – so be careful and consider the position before deciding to sell. Planning opportunities will arise, particularly if both husband and wife are involved in the business and take advice early enough.

A useful relief – but do not take it for granted!

New regime for IHT

Following the pre-Budget report on 9 October, the implications of the changes introduced to inheritance tax are now being seen in practice.

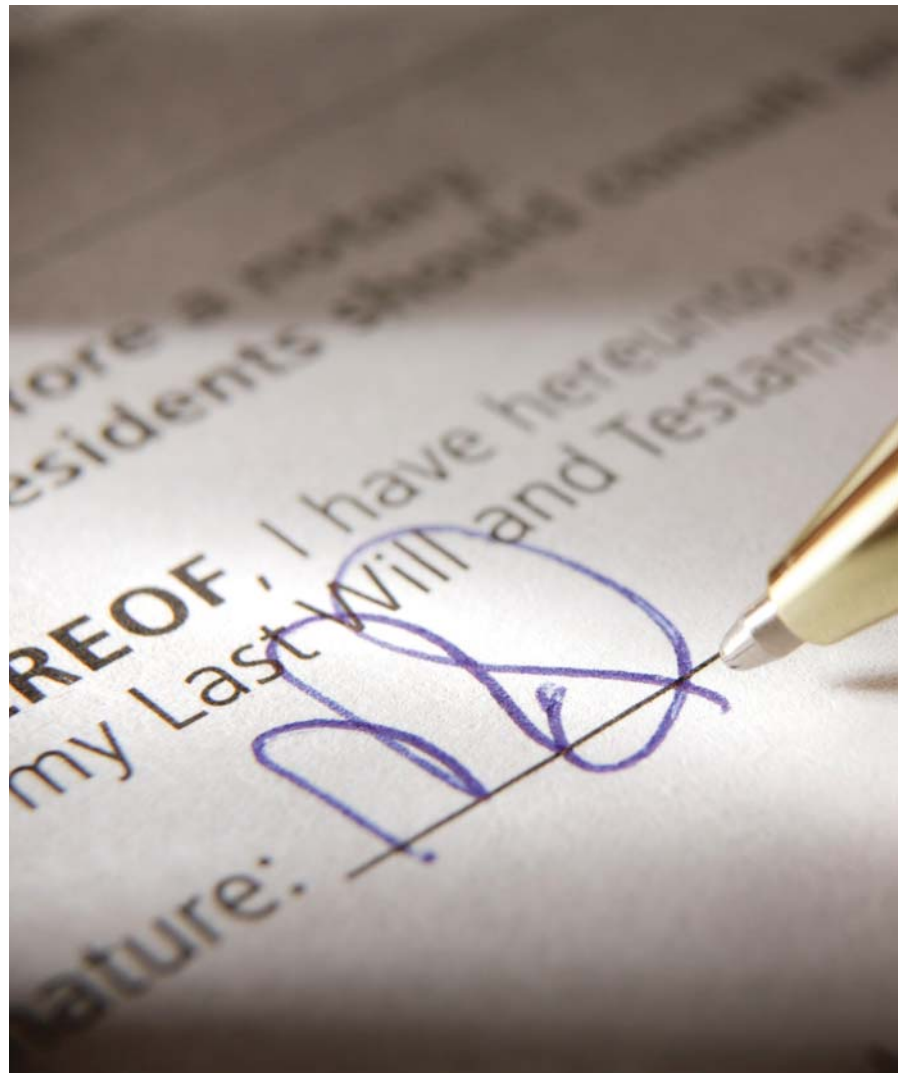


As we previously reported, the PBR introduced significant amendments to the operation of the nil rate band (the amount which each individual can leave free of inheritance tax – currently £300,000). Spouses and civil partners who die after 9 October 2007 will now be able to claim the benefit of any part of the nil rate band which was unused on their spouse or civil partner's earlier death. In many cases, this could increase the nil rate band available on the second death to £600,000 (or more – as the band increases year on year).

There are a number of planning points arising from these changes:-

1. Spouses and civil partners who have Wills simply leaving everything to each other on the first death need generally take no action unless their circumstances change – their position is greatly improved as two allowances should now be available on the second death. However, survivorship clauses should now be avoided and Wills may need amending to reflect this.

2. Spouses and civil partners who have Wills including nil rate band discretionary trusts (whereby an amount equal to the nil rate band is left into a discretionary trust for the benefit of the wider family to make use of the nil rate band on the first death and to prevent it being lost under previous rules) also need take no action. A decision can be deferred until the first death as to whether the trust will be useful from the family's point of view and this will depend on the type of assets, their values and family circumstances. If the trust is not needed, property can simply be appointed out to the surviving spouse within two years of the first death, with the survivor's estate then taking the benefit of two nil rate bands.
3. There are, however, circumstances where it might still be beneficial for spouses and/or civil partners to include a nil rate band discretionary legacy or other type of trust in their Wills:-
 - Where there are succession issues such as second marriages, successive partnerships and stepchildren and the eventual beneficiaries of the two estates might be different.
 - Where there are agricultural or business assets qualifying for inheritance tax relief. Advantage should be taken of the reliefs on the first death in case they are not available on the second.
 - Where there are assets which are expected to increase rapidly in value.
 - For widows and widowers who have remarried who already have the benefit of a transferred nil rate band from their first spouse as no individual can benefit from more than two allowances (the same applies to civil partners).
 - Where there are real concerns about protecting assets from the requirement to pay nursing home fees.
4. There is now no need for tax reasons to equalise the estates of spouses or civil partners or even to ensure that each have assets in their own name to the value of the nil rate band. The exception is where Wills contain a survivorship clause – these should now be avoided and Wills amended if necessary.
5. Widows and widowers whose spouses or civil partners died before



9 October 2007 will also benefit from the new measures. This applies whenever the first spouse or civil partner died. Evidence will need to be obtained of the amount of the nil rate band unused on the first death – often this will mean searching through old files and papers to find the necessary copy Probate papers, valuations and so on from the first death to enable a claim to be made on the second.

6. Where a spouse or civil partner has died within the last two years and the estate is still in the course of administration, advice should be sought as to the best way to take advantage of the new rules. For example, it would not now be advisable to put in place a debt or charge which cannot increase in value on the deceased's interest in the family home to satisfy nil rate band discretionary legacy. It would generally be better to appoint the deceased's interest to a surviving spouse or to his or her civil partner who would get the benefit of any

unused nil rate band on his or her subsequent death.

7. Care must be taken where one spouse or civil partner is not domiciled in the UK as the exemption for transfers between spouses and civil partners is limited in those circumstances.

Generally speaking the changes introduced in the PBR will make Will drafting and estate administration more straightforward. However, trusts are often included in Wills and set up during lifetime for good reasons which are unrelated to tax and this has not changed.

Even with the benefit of a "double" nil rate band, property prices ensure that many couples will still face an IHT liability on the second death and there are a number of lifetime measures which can be taken to mitigate or eliminate this altogether. Please contact us if you would like to discuss your particular circumstances.



I didn't get the opportunity this year to either hear or see the Chancellor present his Budget Speech live.

The first information that I had was comments such as "dull" and "dire" on the television a couple of hours later. Whilst I can fully understand those comments, my initial reaction, as a tax practitioner of many years standing, was one of "thank you".

However, I was somewhat taken aback once I had chance to read all the detailed Press Releases (the so called fine print) which were published just after the Chancellor sat down. These ran to a mere 102 Releases covering 270 pages – well more than is usually the case – and a sure remedy for insomnia!

I am not particularly happy with the extra taxes on beer, wine, spirits, motoring and cigarettes and I am sure that many of you will share my views, whilst others won't! But at least these changes are simple and easy to implement and understand, whether we like them or not.

My focus is on the sheer volume of technical changes that could have been made, but, thankfully, weren't.

The UK tax system is one of the most technically complex in the world. It runs to hundreds of pages and changes almost daily. It is almost impossible to keep up with and there is little doubt that if it was being designed from scratch, it would be nowhere near as complicated as it is.

Thank you Mr Chancellor

Alan Hart comments on the recent Budget.

Yet each Budget increases its complexity.

This year, we had already been notified (in the Pre Budget report in October 2007) of significant changes coming into effect as from 6 April 2008, involving, amongst others:-

- Inheritance tax – use of any unused nil rate band on the first death
- Capital gains tax – single rate of 18%
- Entrepreneur Relief – to reduce the rate of capital gains tax to 10% on the first £1 million of gains, provided certain conditions were met
- Capital allowances
- Taxation of non domiciles
- Changes in the tax rates

In many cases, the draft legislation on these topics to be included in the Finance Bill of 2008 had already been published and commented on in detail. The Budget changed nothing, in principle, on any of these but the Chancellor introduced a few concessions, which are to be welcomed, particularly on the politically sensitive issue of non domiciles.

We feared the "income splitting rules" that were to have been introduced as from 6 April 2008, to reverse the impact of the House of Lords' decision in the well publicised Arctic Systems case. Again, the worry was not so much about the principle of the proposed legislation, but the detail of how it would be drafted to tax the "guilty", but not affect the "innocent". Thankfully, its introduction has been delayed for a year which – hopefully – allows a full and proper debate to be held on the detailed legislation.

We worried about what else the Chancellor would introduce in his Budget to add to the complexity. As expected, there will be legislation to crack down on various tax avoidance schemes.

There will also be legislation to change the taxes on beer, wine, spirits, motoring etc – and let's not forget the possibility of that on carrier

bags. But those changes are simple and easy to implement, whether we support them or not.

Thankfully, there is little that is new!

Parliament will still have its hands full in properly debating the Finance Bill 2008 and, indeed, many (me included!) would argue that a full/informed debate is almost impossible now due to the complexity of our tax legislation- but, at least, the Chancellor has not added to the problem.

That is not something that can be said about any Budget in the last couple of decades or so.

So despite the extra taxes, a qualified "thank you", Mr Chancellor. Let's hope that you and your successors do their bit to make the tax system less complicated – dare I say that you should all (of whatever political persuasion) make a priority of actually simplifying it, rather than just promising to do so.

Information

If you have any queries on any articles in this newsletter please contact:
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