



Have you heard?

CGT - on the way up?

The first "Coalition Budget" will take place on 22nd June. We are told that the capital gains tax rules for "non-business assets" are to be targeted to bring rates of CGT into line with those for income tax. It is unclear precisely what changes will be made and when, but there will be "generous exemptions for entrepreneurial business activities".

What has happened?

- The final Coalition Agreement between the Conservatives and Liberal Democrats of 20 May announced a policy of taxing "non-business" capital gains and income at broadly similar rates. The key passage is set out on the right.
- This would meet a LibDem manifesto pledge to align the rates of income tax and CGT, and will help to fund another such pledge – the £10,000 income tax personal allowance.
- Any change would be limited to "non-business assets" and would include "generous exemptions" for entrepreneurs.
- An "emergency budget" will take place on 22nd June which may include the detailed measures but it is unclear if any increase in rates will take effect from that date or whether it will be delayed until the start of the new tax year.

What does it all mean?

There is still real lack of detail as to what the changes may be and how they may take effect. Indeed, one could ask whether the coalition partners have agreed on what changes should be made ("we will seek ways of taxing"). Similarly, before the publication of the final Coalition Agreement, Nick Clegg's office was reported as expecting any changes to be effective from Budget day, whereas a Treasury spokesman was quoted as saying:

"There are a range of possible options on capital gains tax to fulfil this aim and no decision has yet been taken on one option. It will be important to take the time to get this right."

There are several threads that can be drawn out from this for shareholders in privately-owned companies:

- There will be an increase in the rate of CGT for some investments. This is not unexpected – the gap between the top rate of income tax (of 50%) and the general rate of CGT (18%) meant a change in this area was highly likely at some stage.
- We do not know what shareholdings will be "business assets". If a similar system is adopted as that for entrepreneur's relief (and taper relief before it), then shareholdings in trading companies or groups should be "business assets". It is possible that to qualify for the most generous relief, a shareholder will need to meet further conditions, such as employment, a threshold for the size of the holding or a holding period.
- It is possible that any change could take effect during a tax year, say from Budget day as Mr Clegg has hinted could be the case here. However, such a change would be considerably more complicated to implement as a result of the way that CGT is structured.

"We will seek ways of taxing non-business capital gains at rates similar or close to those applied to income, with generous exemptions for entrepreneurial business activities"

Coalition Agreement, 20th May

"When you have a capital gains tax rate of 18 per cent and a top rate of income tax at 50 per cent, you'll find people finding all sorts of ways to treat income as capital gains."

David Cameron on the Andrew Marr Show, 16th May

- It is quite possible that a shareholder may be no worse off, or perhaps even better off, under the new rules if the "generous exemptions" turn out to be truly generous, at least for those able to benefit. It is also possible, though perhaps less likely, that the coalition parties will be unable to agree the details before 22nd June and no fully thought through change will be announced at that time, with the principles only announced.
- Any distinction between different forms of investment or different asset classes inevitably has a policy angle. For example, politicians have been quick to identify profits on second houses as being undeserving of the lower rate of CGT compared to income tax. On the other hand, entrepreneurial activity is considered deserving of a lower rate. This means that the categories of investment which are to benefit from advantageous rates of CGT are difficult to predict at this stage.
- A separate consultation process was announced in the March Budget to consider "the taxation of geared growth arrangements connected with employment-related securities". The interaction of that consultation with these changes is currently unknown.

What should I do?

There is no "one size fits all" response to the announcements. The approach that shareholders wish to take will vary depending on their personal circumstances. It will also depend on their appetite for risk. For example:

- A management team who are participating and reinvesting in an LBO between now and 22 June should consider whether to bank their 18% (or 10%) rate by paying tax on the entirety of their gain rather than reinvesting by way of CGT neutral rollover.
- Similarly, it is expected that some transactions timetabled to complete at the end of June or in early July will be accelerated to take place before Budget day.
- Where a sale is not currently intended but is expected to take place in the near future, shareholders should consider whether to trigger a CGT liability before 22 June to "bank" the 18% (or, if entrepreneur's relief is available, 10%) rate. Any such tax should be due in January 2012, so cashflow considerations may then come into play if an exit for cash has not occurred by then. It is also important to bear in mind that any such disposal may not generally be "undone" once it has taken place, for example if no exit ultimately occurs, and that the tax cannot be recovered if the shares subsequently fell in value.
- It may be possible to crystallise a disposal for some or all of an existing shareholding without a transaction in contemplation. This would result in a tax bill but would bank the current rate. There may, however, be limitations imposed by the documents providing for the equity investment including shareholders' agreements or the company's Articles.

Shareholders should bear in mind that, as was the case in the March Budget, the new rules may prove no less favourable, or perhaps even more favourable, for certain categories of shareholder, in particular depending on what the proposed "generous exemptions" turn out to be.

There may also be other tax and non-tax considerations, depending on the particular approach adopted and the particular facts and circumstances.

We would be delighted to discuss these proposals with you in greater details, and will provide an update when we hear more.

“Now what we've said is there is a very big difference between the capital gains that someone pays on, say, a second home – which is not, you know, necessarily a splendid investment for the whole economy – there's a difference between that and actual investment in business assets.”

David Cameron on the Andrew Marr Show, 16th May

How to find out more

If you have any questions or would like to know more about how these issues may be relevant to you, please contact:

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