

Have you heard?

An essential tax update for management teams



Entrepreneurs' Relief now worth £900,000

The New Capital Gains Tax Regime

With effect from midnight on 23 June, the capital gains regime changed. A new higher rate of 28% took effect and the lifetime limit for gains attracting entrepreneurs' relief increased to £5 million. A higher rate taxpayer claiming entrepreneurs' relief on £5 million of gain will now be able to achieve a tax saving of £900,000.

How does Entrepreneurs' Relief apply?

Entrepreneurs' relief continues to deliver a 10% rate of capital gains tax on those gains which qualify for the relief. However, it is now available for up to £5 million worth of gains made in your lifetime.

How does the new £5 million lifetime limit interact with the old lifetime limits?

The lifetime limit for entrepreneurs' relief was originally £1 million. This was increased to £2 million (6 April 2010) and has now been raised from 23 June 2010 to £5 million.

Where you have used all or any part of the previous lifetime limits, the amount previously claimed will reduce the amount of the new £5 million limit available to you. You cannot, however, claim further entrepreneurs' relief in respect of gains arising prior to 23 June 2010 which exceeded the lifetime limits at that point.

Example 1

B made a gain of £6 million on 1 May 2010 and claimed entrepreneurs' relief on £2 million of the gain. When the rate went up on 23 June, B's lifetime limit for future gains became £3 million. B cannot, however, claim further entrepreneurs' relief in relation to the £6 million disposal made on 1 May 2010.

Have the qualifying conditions for Entrepreneurs' Relief changed?

No, the conditions have not changed and remain as before. This means that to qualify for relief on the sale of shares or securities, individuals have to:

- be employed by or hold an office of the company,
- hold shares in a trading company or the holding company of a trading group,
- hold those shares for at least one year prior to their sale, and
- hold at least 5% of the ordinary shares and voting rights in the company.

"...to promote enterprise, the 10 per cent capital gains tax rate for entrepreneurs, which currently applies to the first £2m of qualifying gains made over a lifetime, will be extended to the first £5m of lifetime gains."

The Chancellor of the Exchequer
Budget Statement
22 June 2010

Common Traps

Even where the conditions appear to be satisfied, problem areas can arise including:

- managers not holding 5% of the shares by nominal value,
- the existence of preference shares causing the 5% test to be failed,
- the existence of options and warrants which dilute managers' equity holdings on exit to below the 5% level, and
- the group not qualifying as a trading group. Concerns can arise, for example, where the group holds significant amounts of cash or assets as investments.

Is the 18% rate still relevant?

On a disposal of shares or securities on, for example, an exit where your total taxable income and gains in that year are less than the 40% income tax threshold (currently £37,400), the gain will continue to be taxed at 18%.

Where your income and gains exceed the lower rate threshold, the amount of the gain which exceeds the threshold will be taxed at 28% and the gain below the threshold will be taxed at 18%. You may therefore wish to use spouse transfers to optimise the use of the 18% rate.

Example 2

A sells shares on 25 July and realises a gain of £10,000. His income for the 2010/11 tax year is £30,000. The first £7,400 of the gains (£37,400 - £30,000) are taxed at 18% and the balance which exceeds the threshold, £2,600, is taxed at 28%.

Going forward

In spite of the increase in tax rates, capital gains tax still remains at a significantly lower rate than income tax on either dividends (36.1%) or employment earnings (51%) and therefore realising value from shares and securities in capital form will remain a priority for many management teams.

The extension to entrepreneurs' relief also increases its importance and the availability of the relief will become a key consideration in structuring new and existing share incentive arrangements for employees and directors.

Whilst the announcement of these changes has clarified the position in the short term, there may be further developments to come over the next few months. The Government has refused to rule out a further increase in rates at the next Budget and a wide-ranging consultation on the tax treatment of employment related share arrangements is due to take place in the latter part of this year which could result in significant changes to law in this area.

How to find out more

We can advise on the availability of entrepreneurs' relief to your team and on ways in which current and future arrangements can be changed or structured to benefit from the relief.

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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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