TURCAN CONNELL

Briefing Note

Changes to Capital Gains Tax

Capital Gains Tax

The Budget announced a welcome reduction in the rates of Capital Gains Tax (CGT) by 8% from April 2016. This will mean that the rate of CGT paid by higher-rate taxpayers will reduce from 28% to 20%. The 18% rate applying to basic-rate taxpayers will also reduce from 18% to 10%. This will mean significant tax savings for those disposing of assets such as shares (outside of an ISA), where their gains in a tax year exceed the annual exemption.

Trustees and Executors will also benefit from a reduction of their rates from 28% to 20%. The 28% rate will continue to apply to gains relating to carried interests in investment funds.

Residential Property

Importantly, for owners of buy-to-let property or second homes the new rates will also not apply to sales of residential property. They will continue to pay CGT at 28% or 18% when they dispose of the property. Main residences will continue to be exempt from CGT and so the changes to the rates will not affect most people when they move home.

ATED-related gains for companies will also continue to be taxed at the 28% rate.

Entrepreneurs' Relief – Extension to Long Term Investors

Introduced in 2008, Entrepreneurs' Relief applies a lower CGT rate of 10% to sales of business assets and shares where several key conditions are met. Up until now, it was only available for shares where the shareholder was also an employee or director of the company and, in most cases, held at least 5% of the shares.

The Budget has introduced a significant extension to Entrepreneurs' relief so that it can potentially apply to all holdings in unquoted companies, without the need to be an employee or hold a certain proportion of the shares. To qualify for the extended version of the relief, the shares must:

- Be in a unquoted trading company (or holding company of a trading group),
- Have been acquired through a subscription after budget day of 16th March 2016,
- Have been held for at least three years from 6th April 2016 (and therefore the relief can only apply to a sale from April 2019 at earliest).

The relief applies a CGT rate of 10% to the qualifying gains. Each taxpayer can claim relief on a maximum of £10 million of gains over their lifetime. However, this is a separate limit to the cap that applies to gains covered by the pre-existing Entrepreneurs' Relief rules.

Entrepreneurs’ Relief – Relaxation of Existing Rules

The 2016 Budget has announced the relaxation of several changes that were introduced in 2015. These rules heavily restricted the availability of Entrepreneurs’ Relief in certain circumstances. This led to some anomalous results and, after lobbying by the professional bodies, some of these restrictions have been altered so that Entrepreneurs’ Relief will continue to be available in some situations. The updated rules will be backdated so that they can apply to disposals previously caught by the 2015 changes.

Firstly, Finance Act 2015 withdrew relief on certain “associated disposals” (i.e. of business assets held personally, but used by a partnership or company). This applied where there were arrangements for connected persons to acquire the shares or partnership interest. This could have applied to a wide range of genuine transactions, such as passing a business to the next generation. The new rules confirm that this restriction will only apply where there are arrangements that take effect after the qualifying disposal. This is particularly important to farming partnerships where land is held outwith the partnership. There will also be a relaxation to the requirement that the shares or partnership interest represents a 5% interest, but only where there is a sale of the full interest and a 5% interest was held in the past.

Secondly, the Finance Act 2015 revisions prevented relief applying to certain company structures, on the basis that interests in some underlying entities were not regarded as being trade assets. The relief now takes into account trading activities taking place within joint ventures or partnerships held by the company in determining whether it meets the trading test.

Finally, the Chancellor announced in his 2015 Autumn Statement that he would remove Entrepreneurs’ Relief from applying on the sale of Goodwill to related companies, which meant that relief was denied where the seller received any shares in the acquiring company. Under the new rules, Entrepreneurs’ Relief will apply provided their interest is less than 5% and the acquiring company is a close company (i.e. a company controlled by its directors or no more than five participators).

Employee Shareholder Shares

A £100,000 cap will be applied to the CGT exemption on shares acquired under the Employee Shareholder scheme. This will only apply to new agreements made from 17th March 2016.

The scheme allows an employee to be granted free shares in a company in return for giving up certain employment rights. Previously, the capital gain realised on the shares would be completely free of CGT and this treatment will continue for shares that have already been granted.