

Trust Practitioner's Handbook (2nd edition)

By

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with contributions by Robert Mowbray and Charles Christian

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CGT & Trusts – Chapter 10 (update)

The Pre-Budget Report in October 2007 announced the simplification of CGT the details of which were contained in Finance Act 2008. Between October 2007 and the Finance Bill gaining Royal Assent in 2008 there was much lobbying to try and improve the situation particularly in relation to the new Entrepreneur's Relief. Whilst simplification is welcomed the provisions in relation to Entrepreneur's Relief for trusts need improvement.

This is not intended to be exhaustive but should help the practitioner spot significant developments since the second edition of the Trust Practitioner's Handbook was published.

With effect from 6 April 2008

- There is a flat rate of tax at 18% which applies to individuals, personal representatives and trustees – it follows that there is no top-slicing of the gain onto the taxpayer's highest marginal rate of income tax. The simplification is welcome but it does come at a relatively high price in some cases.
- Taper Relief has been abolished on disposals or in relation to held over gains coming into charge on or after 6 April 2008 – whilst this relief was unduly complex it did have the effect of reducing the previous top rate of tax on business disposals from 40% to 10% and was applicable to an unlisted company or partnership as well as to an individual because it applied to assets used in a business without the taxpayer owning the asset having to have any interest in the business as a shareholder, partner or sole trader. This helped trustees of trusts who were minded to invest in farmland or commercial property which would be let to tenants. Trustees can only benefit in a limited way from the new Entrepreneur's Relief.
- Indexation Allowance has been removed in respect of assets owned before 6 April 1998 – this allowance had the effect of removing inflation from any potential gain as measured by the Retail Prices Index in the period between March 1982 and April 1998. For some long standing property owners (especially

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farmers) the loss of this relief is greater than the loss of Taper. When an owner acquired an asset before April 1982 the Indexation allowance on disposal on or after April 1998 would have been just over 100% of the 31 March 1982 value.

- The 'kink test' for assets held on 31 March 1992 has been abolished – this had the effect that the gain (or loss) on the disposal of an asset held on 31 March 1982 was the lower of two amounts:
 - The gain (or loss) calculated by reference to the original acquisition cost of the asset (and any other allowable expenditure on it), and
 - The gain (or loss) based on treating the value of the asset on 31 March 1982 as the total allowable expenditure up to that date

The abolition of the 'kink' test means that all assets held on 31 March 1982 will be deemed to have had a cost equivalent to their market value on that date. For example, in 1960 Joan purchased some shares costing £600. In March 1982 they were worth £450. In August 2008 she sells the shares for £25,000. To calculate her CGT liability Joan will need to deduct from the disposal proceeds of £25,000 the March 1982 valuation of £450 giving £24,550 – she cannot deduct the actual cost of the shares of £600 as the abolition of the 'kink' test means she has to use the March 1982 value.

Also, the combination of the loss of Indexation and the 'kink' test operates severely against farmers. For example, Farmer Giles owned 100 acres of farmland worth £2,000 per acre in 1982 compared to £5,000 per acre in 2008. A sale in 2007/8 would produce an indexed capital gain of approximately £100,000 and a tax liability (ignoring annual exemption) of **£10,000**. By contrast, an equivalent sale in 2008/9 would produce a capital gain of £300,000 and a tax liability at 18% of **£54,000!**

- The treatment for the disposals of shares has been simplified.
- Capital losses brought forward and arising in the current year will still be available to offset against gains.
- The CGT annual exemption (£5,050 for trusts for 2009/10) will still be available.
- Other CGT reliefs which still apply include Loss relief; Principal Private Residence Relief (PPR Relief), Business Asset roll over relief (BAR Relief);

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Business Asset hold over relief (BAH Relief), Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) relief.

For some people these changes will be beneficial e.g. owners of non-business assets like second homes where the previous 'best rate' of CGT would have been 24%; but for others, unless the proposed Entrepreneur's Relief can apply to them, the change may well be less beneficial – this is particularly so where the donors have owned the asset in question for a considerable time

Entrepreneur's Relief

s.7 and Schedule 3 Finance Act 2008 sets out the amendments to TCGA 1992 to introduce the new ER which applies for qualifying disposals made on or after 6 April 2008.

ER has similarities with the old retirement relief but it is specifically not related to retirement and is designed to encourage entrepreneurship by enabling entrepreneurs to realise value by disposing of their business at a low rate of tax irrespective of when they choose to do this. However, although this makes ER closer in philosophy to the Taper Relief on business assets some people who would have qualified for business asset taper relief on gains will not qualify for ER e.g. employee shareholders with less than 5% holdings and owners of assets used in a business where the criteria for ER cannot be met.

ER has to be **claimed** (unlike Taper Relief and the old retirement relief) and applies to "**qualifying business disposals**". The claim has to be made within twenty-two months after the relevant tax year in which the disposal is made i.e. by 31 January following the end of the tax year in which the qualifying business disposal is made – s.169M (3) TCGA 1992.

The first £1 million of gains (a lifetime limit for disposals on or after 6 April 2008) that qualify for ER will be charged to CGT at an effective rate of 10%. Gains in excess of £1 million will be charged at the normal 18% rate.

Where a claim is made the relevant gains are to be aggregated and any relevant losses are to be aggregated and deducted from the aggregate gains; the resulting amount is to be reduced by 4/9th and that reduced sum is treated for the purposes of CGT as a chargeable gain accruing at the time of the actual disposal by

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reference to which this deemed gain is calculated.

Trusts

Trustees will be able to claim relief on certain disposals of business assets and company shares and securities where a “qualifying beneficiary” has a qualifying interest in the business in question.

Trustees must make claims jointly with the “qualifying beneficiary”. Any relief given on the trustees' gains will reduce a beneficiary's lifetime limit on the relief.

Transitional provisions apply in certain circumstances where gains that have been deferred from disposals made on or before 5 April 2008 become chargeable after that date.

It will be necessary to keep a record of the amount of gains in respect of which the relief is claimed to work out the relief due on any later qualifying disposals.

Claims must be made on or before the first anniversary of 31 January following the tax year in which the qualifying business disposal is made.

The relief applies to gains arising on the disposal of the whole or part of a qualifying business. For trusts a qualifying disposal of “settlement business assets” means a disposal of:

1. Assets consisting of (or of interests in) shares in or securities of a company; or
 2. Assets (or interests in assets) used or previously used for the purposes of a business
- which are part of the settled property.

An individual will be a “qualifying beneficiary” of the settlement if he has an interest in possession under the settlement (otherwise than for a fixed term) in

- The whole of the settled property; or
- A part of it which consists of or includes the settlement business assets disposed of.

On a disposal of shares or securities the relief will only apply if throughout a period

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of one year ending not earlier than three years before the date of disposal:

(a) The company is the qualifying beneficiary's personal company and is either a trading company or the holding company of a trading group, and

(b) The qualifying beneficiary is an officer or employee of the company or (if the company is a member of a group of companies) or one or more companies which are members of the trading group.

Similarly, if the settlement business assets disposed of are assets used for the purposes of a business they have to have been used for the purpose of a business carried on by the qualifying beneficiary throughout the period of one year ending not earlier than three years before the date of the disposal and the qualifying beneficiary ceases to carry on the business on the date of the disposal or within the period of three years before that date.

For these purposes the business carried on by the qualifying beneficiary includes a business carried on by a partnership of which the qualifying beneficiary is a member and the reference to ceasing to carry on the business therefore relates in such circumstances to the beneficiary ceasing to be a member of the partnership or the partnership ceasing to carry on business.

Where there is more than one beneficiary of the trust who has an interest in possession in the whole or part of the trust at the time the disposal occurs only the relevant portion of the gain can be relieved as is represented by the qualifying beneficiary's share of the income. For example, if two beneficiaries share the interest in possession equally and only one is a qualifying beneficiary then only 50% of the chargeable gain arising on the disposal of settlement business assets will be eligible for ER.

Where there are more than one beneficiary eligible for relief the best approach is to focus on one beneficiary at a time and establish if all the conditions for the relief have been met in relation to that beneficiary and then restrict the level of relief that can be claimed by the trustees by reference to each eligible beneficiary's relevant proportion.

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Practice point

- Can tax advisers act for both the trust and the beneficiary in ER claims? It would seem not as there is an inherent conflict of interest as to whether the beneficiary should agree to give up his lifetime ER in favour of the trust.

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