

Capital gains tax: relief on disposal of a business (entrepreneurs' relief)

Examples

This document supports the Budget Note 'Capital gains tax: relief on disposal of a business (entrepreneurs' relief)'. It provides examples of how the new relief will work in practice.

1. Miss S sells her trading business in 2008-09 and realises gains of £250,000 on her factory premises and £300,000 on goodwill but a loss of £100,000 on her retail shop giving net gains of £450,000 (before entrepreneurs' relief). She has made no other claims to the relief and the whole of the gains are eligible for relief.

If Miss S claims entrepreneurs' relief the gains of £450,000 will be reduced by 4/9ths (so reduced by £200,000, resulting in a chargeable gain of £250,000). Miss S has no allowable losses and no other gains in that year so she deducts the annual exempt amount (AEA) £9,600 giving an amount chargeable to CGT of £240,400. This amount is taxed at 18% giving tax payable of £43,272.

2. Mr W sells his shares in a trading company in 2008-09 and realises a gain of £360,000. He has owned 50% of the ordinary shares of the company, which gave him 50% of the voting rights, for several years, during which time he has been a director of the company. He therefore qualifies for entrepreneurs' relief on the disposal of his shares.

On making a claim, Mr W's gain is reduced by 4/9ths, resulting in a chargeable gain of £200,000. He has no allowable losses or other chargeable gains, so after deduction of the annual exempt amount (AEA) £9,600 he has an amount chargeable to CGT of £190,400. This amount is taxed at 18%, giving tax payable of £34,272.

3. Mrs L sells her trading business in 2008-09 and realises gains of £1,300,000 (before entrepreneurs' relief). She has made no other claims for the relief, and the whole of the gains are eligible for relief. She claims entrepreneurs' relief.

The maximum amount of gains on which entrepreneurs' relief can be claimed is £1 million. So £1 million of Mrs L's gains is reduced by 4/9ths (to £555,555), and the balance (over the £1 million) of £300,000 is chargeable in full, resulting in net chargeable gains of £855,555. She has no allowable losses or other chargeable gains, so after deduction of the annual exempt amount (AEA) £9,600 she has an amount chargeable to CGT of £845,955. This amount is taxed at 18%, giving tax payable of £152,271.90.

4. Mrs F sells her trading business in 2008-09 and realises gains of £720,000. This amount qualifies in full for entrepreneurs' relief, which she claims, and the gain is reduced by 4/9ths, resulting in a chargeable gain (before any deduction for losses or annual exempt amount (AEA)) of £400,000. From January 2009 to September 2013 Mrs F is a director of trading company P Ltd, and owns 15% of the ordinary share capital, which entitles her to exercise 15% of the votes. In September 2013 she sells her shares, realising a gain of £400,000. She claims entrepreneurs' relief.

Mrs F has already had relief in respect of gains of £720,000, and there is a limit of £1 million in respect of which she can claim the relief. So £280,000 of the £400,000 gain qualifies for relief and is reduced by 4/9ths to £155,555, and the balance of £120,000 is chargeable in full, giving a net chargeable gain (before deduction of any allowable losses and the AEA) of £275,555.

5. In 1995 Mr E purchased a buy-to-let property for £100,000 that is let out on an assured short-hold tenancy basis. In October 2008 he sells the property for £250,000. The CGT due is calculated by deducting the purchase cost from the sale proceeds giving a gain of £150,000. This gain is not eligible for entrepreneurs' relief.

Mr E has no allowable losses or other capital gains in that year so he can deduct the full annual exempt amount (AEA) of £9,600 giving an amount chargeable to CGT of £140,400. This amount is taxed at 18% giving tax payable of £25,272.

6. Mr R has been a member of a trading partnership for several years. He leaves the partnership and disposes of his interest in partnership assets to the other partners, realising gains of £125,000, all of which qualify for entrepreneurs' relief. He also sells the partnership office building which he owned outright, but let to the partnership, realising a gain of £37,000. The disposal of the office building is "associated" with Mr R's withdrawal from the partnership business, and the £37,000 gain therefore also qualifies for entrepreneurs' relief (assuming there is no restriction on the amount of the gain qualifying for relief as a result of non-qualifying use).

Mr R claims entrepreneurs' relief in respect of total gains of £162,000. This amount is reduced by 4/9ths, resulting in a chargeable gain of £90,000. Mr R has no allowable losses or other gains, so after deduction of the annual exempt amount (AEA) £9,600 there is an amount chargeable to CGT of £80,400. This amount is taxed at 18%, giving tax payable of £14,472.

7. Mrs N sells her business in 2009 and realises a gain of £99,000 that qualifies for entrepreneurs' relief. She claims the relief, but also makes an investment of £80,000 in qualifying EIS shares and claims to defer the gain.

Mrs N's gain of £99,000 is reduced by 4/9ths, resulting in a chargeable gain of £55,000. The investment in EIS shares exceeds £55,000, so the whole of the chargeable gain of £55,000 is deferred. This amount will come into charge at some later time under the normal EIS rules for charging deferred gains.

8. Mr C sold his trading business in May 2006 and realised a gain of £270,000. He invested this amount in qualifying EIS shares in July 2006, so the gain was deferred. In September 2009 he sells the EIS shares and the deferred gain becomes chargeable to CGT.

The gain on the disposal of the business in 2006 would have qualified in full for entrepreneurs' relief if the relief had been available at that time. So Mr C can claim entrepreneurs' relief in respect of the deferred gain, and if he makes a claim the deferred gain is reduced by 4/9ths, resulting in a chargeable gain (in September 2009 when he disposes of the EIS shares) of £150,000 (before any deduction for losses and annual exempt amount (AEA)).

9. Mrs A exchanges her shares in the trading company Y Ltd for qualifying corporate bonds (QCBs) in 2010. For some years she has been an employee of Y Ltd, owning 10% of the ordinary shares, which entitle her to exercise 10% of the votes in the company. She therefore meets the conditions for claiming entrepreneurs' relief in respect of her shares in Y Ltd. The normal rules for share exchanges apply and there is no immediate charge to CGT in 2010 when she exchanges the shares, but the gain that would arise on a disposal of those shares for full market value at the date of the exchange is calculated. The calculation results in a gain of £63,000.

Mrs A's gain of £63,000 will become chargeable to CGT when the QCBs are redeemed or she disposes of them in any other way. If Mrs A claims entrepreneurs' relief in respect of the £63,000 gain it will be reduced by 4/9ths to £35,000 and that will be the amount that becomes chargeable when she disposes of the QCBs.

10. Mr D exchanged his shares in trading company Z Ltd for qualifying corporate bonds (QCBs) in 2007. Before the exchange he had, for several years, been a director of Z Ltd and owned 25% of its ordinary share capital, which entitled him to exercise 25% of the votes in the company. A gain of £315,000 was deferred as a result of the exchange. In August

2010 the QCBs are redeemed, and the gain of £315,000 becomes chargeable.

At the time of the exchange Mr D's gain would have qualified for entrepreneurs' relief if the relief had been available in 2007. So Mr D can claim the relief, and the gain of £315,000 is reduced by 4/9ths, resulting in a chargeable gain (before deduction of any allowable losses and the annual exempt amount (AEA)) of £175,000.

11. In August 2009 Miss K exchanges her shares in the trading company X Ltd for shares issued by a new company, H plc. For some years she has been an employee of X Ltd, owning 40% of the ordinary shares, which entitle her to exercise 40% of the votes in the company. She therefore meets the conditions for claiming entrepreneurs' relief in respect of her shares in X Ltd. But in the exchange she receives shares amounting to only 2% of the ordinary shares of H plc. This is below the minimum 5% holding requirement, so Miss K will not be able to qualify for entrepreneurs' relief on a disposal of her new shares in H plc.

Under the normal rules for share exchanges Miss K would be treated as making no disposal of her shares in X Ltd at the time of the exchange in August 2009 and there is no immediate charge to CGT then. These rules would therefore mean she loses all possibility of claiming entrepreneurs' relief. In order to allow a claim to the relief she can elect to disapply those normal rules. Disapplying the rules means that she is treated as disposing of the shares in X Ltd at the time of the exchange in August 2009. She can then claim entrepreneurs' relief on the gain arising on that disposal.

Published 12th March 2008