

CAPITAL GAINS TAX: EXTENSION TO BUSINESS ASSETS TAPER RELIEF

SUMMARY OF REPLIES TO CONSULTATION

Introduction

1. In the 8 November 2000 Pre-Budget Report (PBR – Cm 4917), the Chancellor announced consultation on how to implement changes to the Capital Gains Tax (CGT) incentives for employee shareholders.
2. Twenty three written responses to the [press notice](#) were received. The Government is very grateful to all those who took the time and trouble to comment. In addition, the Inland Revenue convened a Review Group of professional bodies. The Review Group met twice. A list of members of the Review Group is at Annex A.
3. This document summarises the main elements of the written responses. A copy of this summary has been sent to everyone who responded in writing and to Members of the Review Group. Copies of individual submissions may be obtained by contacting the Inland Revenue at the address below unless, exceptionally, a respondent has asked for confidentiality.
4. The Government announced its decisions in the 7 March 2001 Budget. Further details are in the [Inland Revenue Budget Note Capital Gains Tax: Business Assets Taper Relief](#).

Background

CGT Taper Relief

5. CGT taper relief was introduced in the Finance Act 1998. Significant amendments were made in the Finance Act 2000 to the rate of and entitlement to business assets taper relief.
6. Taper relief reduces the amount of a capital gain which is charged to tax on the disposal of an asset. The reduction increases up to a maximum rate the longer that asset has been held after 5 April 1998. Taper relief applies to the capital gains of individuals, trustees and the personal

representatives of deceased persons, but not to the chargeable gains of companies.

7. The gains subject to taper are those after indexation for the period held pre-1998 and after deduction of allowable losses.
8. Different taper rates apply to business assets and non-business assets.
9. For periods of ownership from 6 April 2000, for an individual, business assets include:
 - assets used by the owner for the purposes of a trade; and
 - shareholdings in a trading company or the holding company of a trading group if:
 - ❖ The individual is an employee of the company or of a company in the group; or
 - ❖ The company is unlisted; or
 - ❖ The company is listed and the individual is able to exercise not less than 5% of the votes.
10. CGT taper relief reduces the taxable gain on a business asset from 100 per cent if the asset has been held for less than one year to 25 per cent if held for more than 4 whole years after 5 April 1998 - effectively the rate of tax for a higher rate taxpayer is reduced from 40 per cent to 10 per cent.
11. For a non-business asset, CGT taper relief reduces the taxable gain from 100 per cent if the asset has been held for less than 3 years after 5 April 1998 to 60 per cent if held for more than 10 years - effectively a reduction in the CGT rate for a higher rate taxpayer from 40 per cent to 24 per cent.

The Pre-Budget Report (PBR)

12. The November 2000 PBR said (at paragraph 3.55):

To encourage further employee shareholding and foster a more enterprising and productive relationship between firms and their employees, the Government extended in Finance Act 2000 the more generous business assets rate of capital gains tax taper relief to all disposals of shares held by employees in their companies where the companies were wholly (or almost wholly) trading. So that more companies and employees can benefit and to reduce their compliance costs, the Government is proposing to extend the benefit of the business assets taper to include employees of a range of non-trading companies from 6 April 2000. The Government will consult regarding the appropriate level of revenue protection.

13. The [Inland Revenue Press Release PR REV2/2000](#) dated 8 November 2000 invited comments on the PBR proposals.

Overview of who Responded

14. We received 23 letters and e-mails in reply to the press release:

Type of Respondent	Number of Replies	%
General business and shareholder representative bodies	3	13
Venture Capitalists, organisations representing them, and their employees	3	13
Accounting, tax and legal firms and professional bodies	11	48
Companies	6	26
<i>TOTAL</i>	<i>23</i>	<i>100</i>

15. A number of telephone calls were received.
16. The Inland Revenue convened a Review Group which met twice. A list of bodies represented in the membership of the Group is at Annex A.

Summary of Replies on the Proposal

17. This section summarises the main elements in the replies received under a number of broad headings.

General Support for the Proposal

18. The proposal to extend business assets taper relief to employees of a range of non-trading companies was uniformly welcomed.

Regulatory Impact

19. Some saw compliance cost savings as a number of firms would no longer be asked by their shareholders whether they were “trading” for the purposes of CGT taper relief. No estimate was provided of the scale of the savings.

General Acceptance of the Need for Revenue Protection Measures

20. Respondents generally accepted the need for measures to protect tax revenue if business assets taper relief was extended to shares in non-trading companies. The Inland Revenue's concerns that people might securitise their assets were seen as justified.
21. However, a number of respondents pointed out the difficulties and costs (including tax costs) of such securitisation, and doubted whether abuse would in fact be widespread.

Revenue Protection Measures to be Used

22. **Close Company Test.** The Inland Revenue's press notice had suggested excluding close companies from the new relief in order to protect revenue. That is, close companies would continue to have to be trading in order for shares in them to benefit from business asset taper relief.
23. No respondent supported a close company test of the sort envisaged. It was felt to exclude deserving employees of close companies. And it was suggested that some companies – especially non-UK companies – would find it hard to know whether they were close.
24. A number of respondents, not necessarily supportive of having any close company test, suggested variations on a straight close company test, including:
 - Only apply the test to close companies formed after the date of the PBR announcement;
 - Exclude only cases where an individual transferred assets into a close company;
 - Two respondents asked that companies that were close only because an employee benefit trust controlled them should not be treated as close for this purpose;
 - Do not treat as close those companies that own industrial trading estates, where the company qualifies for industrial buildings allowance;
 - Listed close companies should not be barred from the relief;
 - Close companies where there is at least 20% unconnected equity investment should not be barred from the relief; and
 - For close companies, extend the relief to cases where the companies had been active for a period of two years, where the

new investor had not previously held shares in the company, and where s/he is not related to any of the controlling shareholders.

25. **Material Interest Test.** A number of respondents favoured a material interest test, or in some cases saw it as a fall back if their preferred tests were not adopted. Under such a test, an employee would have business asset taper relief on their shareholding provided that he or she (together with associates) owned less than x% of a stake in the company.
26. Suggestions for the level of “x%” were: the figure that gave control and percentages from 5 to 30%.
27. Some suggested that the test should be applied to all non-trading companies. Others suggested that the test should only be applied to close non-trading companies (ie that all employee shareholders in non-close non-trading companies should benefit from business assets taper relief, whatever the size of their shareholding).
28. **Working Time Test.** Some favoured a working time test. Suggestions for the formulation of such a test included:
 - A requirement to spend at least 20% of a person’s working time with the company; and
 - Genuine full-time employees.
29. It was recognised by some respondents that in some formulations a working time test might discriminate unfairly against women who were thought to be more likely to work part time than men.
30. **Purposive Test.** Some suggested a purposive test. For example, access to the relief could be denied where it was a or the main purpose of the company to enable business asset taper relief to be obtained. However, it was recognised that such a test might bring uncertainty and that a clearance procedure might be needed.
31. A variant would be to impose limits on the sort of investment that a non-trading company could undertake and still have its shareholdings qualify for business assets taper relief.

Consequential Changes

32. It was hoped that the change would be extended to **shares owned by trusts** where an eligible beneficiary worked for a non-trading company.

Other Issues Raised

33. Some of the replies also raised a number of other issues on CGT taper relief that were not the subject of consultation. The Inland Revenue will

nonetheless be addressing some of the concerns expressed by issuing guidance notes during 2001 on:

- The definition of a “trading company”, “holding company of a trading group” &c;
- The meaning of terms used in the anti-avoidance provisions which apply when a close company changes its activities; and
- The meaning of “security” for the purposes of taper relief.

Contacts

34. For media inquiries, please contact:

- Normal working hours: 020 7438 6692/ 6706/ 7327
- Out of hours: 07860 359544

35. Non-media enquiries about CGT taper relief should be addressed to: 020 7438 6420/6425.

36. Requests for copies of individual responses to consultation, should be addressed to:

Marlette Bennett
Capital Taxes Policy Group
Room 124
New Wing
Somerset House
London
WC2R 1LB

Tel 020 7438 7762
Fax 020 7438 6380

E-mail: marlette.bennett@ir.gsi.gov.uk

**Inland Revenue
Capital Taxes Policy Group**

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MEMBERS OF THE REVIEW GROUP ON TAPER RELIEF

(not all members attended meetings)

Association of Chartered Certified Accountants

Association of Investment Trust Companies

Association of Unit Trusts & Investment Funds

British Property Federation

British Venture Capital Association

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Chartered Institute of Taxation

Confederation of British Industry

Department of Trade & Industry

Federation of Small Businesses

Institute of Chartered Accountants in England and Wales

Institute of Chartered Accountants of Scotland

Institute of Directors

The Law Society of England & Wales

Law Society Scotland

ProShare UK Ltd

Quoted Companies Alliance

Small Business Service