

# WILKINSON & PARTNERS LIMITED

ACCOUNTANTS

## Special Newsletter 2008

### Capital Gains Changes

Back in the Autumn, Alistair Darling made a number of announcements concerning proposed changes to the capital gains system. These changes would lead to a significant simplification of the rules, but as with most changes there were going to be both winners and losers. The changes were heavily criticised by the business community and consequently a number of further changes were recently announced and an Entrepreneurs relief is to be introduced.



Although, the rules are still not in place, the changes will come into force in April and a summary of the rules is shown below.

- Indexation allowance to be abolished
- Taper Relief to be abolished
- Gains to be taxed at a rate of 18%
- Entrepreneurs rate of 10% for certain business assets to be introduced.
- Annual exemption relief to remain
- Private residence relief for own home will still be available.

The removal of indexation and taper relief could have a significant impact on the tax that may be payable on the disposal of assets and it may be preferable to make a disposal before April to ensure that these reliefs are not lost.

Indexation allowance applies to assets that were acquired before April 1998 and in some circumstances can significantly reduce the gain arising on a disposal by taking into account inflationary increases. Although, this relief was frozen in 1998, the impact of inflation can have a significant effect where assets were acquired before this date and especially so for assets acquired during the 1980's. As this relief is to be removed from April, it might be worthwhile making a disposal of the asset this year. A husband and wife may be able achieve this result via a transfer of assets between them.

Taper relief was introduced by Gordon Brown in 1998 and allowed the amount of any gain to be reduced to take into account the length of ownership and could significantly reduce the tax payable. There are two rates of relief depending upon whether the asset is a business or non business asset, with business assets being treated far more favourably. It was the removal of the business rate that caused large criticism and led to the introduction of the new entrepreneurs rate of 10%

Subject to entitlement to entrepreneurs relief, capital gains will be taxed at a rate of 18%. For disposals of non business assets then this may well result in a lower tax charge than under the current rules.

### Entrepreneurs relief

This relief is a replacement for business asset taper relief and for many the tax payable under the old and the new rules will be broadly similar. There are however a number of important changes

- More restrictive definition of a business asset
- Lifetime limit on the gains qualifying for a relief of £1,000,000

It is therefore quite possible that an asset that would qualify as a business asset now will not be included within the new relief and this is especially relevant to minority company shareholders holding less than 5% of the shares in their company.

### Action needed?

If you currently own assets that have increased in value and on which capital gains may be payable then you should consider whether you will be a winner or loser under the new rules and if so what action needs to be taken. If you think that you may be affected by the changes and would like to discuss matters further then please let us know.

# Income Shifting

## What is Income Shifting?

The government has for a number of years been concerned by the level of tax being paid by small business and the tax saving opportunities that have been available to many of the business owners by the splitting of income between spouses and civil partners. This was typically achieved within a company by splitting the ownership of the shares between the couple, so that any dividends received would be shared between them. This splitting of income helped to minimise an individuals personal higher rate tax liability and has been used successfully for a number of years. The government did attempt to block this tax planning and took the matter before the courts. They lost and as a consequence new legislation is planned to come into force in April which will seek to tax income which has shifted from one person to another and where tax has been saved as a result.

## Who will be affected by the rules?

Many small family run businesses may be affected by the proposed rules as they will apply where company dividends are paid and where profits are distributed by business partners. Where an individual receives income that is not based upon their contribution to the business then these rules could apply to them.

Many small companies draw very small salaries and distribute the profits of the business as a dividend to the shareholders. Where this distribution does not reflect the efforts of the shareholders and there is a higher rate tax saving as a result then this may fall within the new rules as income may have been shifted from one individual to another.

These rules do not only apply to married couples and all individuals could be caught.

## How will I know if income has been shifted?

If an individual sets up a business and passes to their spouse income that is above a market rate for the work undertaken then this may be shifted income. But how do you quantify the market rate of the work undertaken? - the revenue appear to consider that this task will be relatively straightforward, but the reality may be very different. The spouse may only be undertaking administration tasks for 10 hours a week, but this may be spread unequally and at unsociable hours. Where an office is maintained at home, then the spouse may be on call to man the office. Although the actual amount of work undertaken may be minor the cost of employing someone to undertake a similar task may be substantial. The spouse may also be actively involved in the business decision making process and again it may be very difficult to substantiate the value of this work.

## How will this income be taxed?

If income has been shifted within a business then the revenue will expect this to be reflected with the self assessment return by declaring and paying the tax on the income that they have foregone in favour of another. In this way the revenue will receive the additional higher rate tax that they believe to be due.

## Action needed

If you believe that you may be affected by the rules, then please contact us to discuss the position further. We can then discuss the likely tax impact and consider the further action, if any that needs to be taken. It may be worthwhile considering the payment of additional dividends before 6 April 2008 to take advantage of the existing rules.



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