



## Entrepreneurs' relief: don't assume clients will pay less!

**W**hile increasing entrepreneurs' relief to £5 million will have been welcomed by successful business people, it is a lifetime limit and, for serial and highly successful entrepreneurs, is not enough to offset the increase in capital gains tax (CGT) to 28%, also announced by George Osborne in the June Budget. With the cost of losing entrepreneurs' relief now £900,000, careful planning is more important than ever.

Entrepreneurs realising a qualifying capital gain of up to £5 million are now better off. However, serial entrepreneurs will find they are paying more CGT overall. As the amount of realised gain increases, the impact of the increase in the CGT rate is greater than the advantage of a higher lifetime limit for entrepreneurs' relief. The cross over point is a little below £7 million (£7,410,100 in the 2010/2011 tax year).

### Who qualifies for entrepreneur relief?

To qualify for entrepreneur relief a shareholder must own at least 5% of the voting shares in a trading business and must be an employee or officer of the company. This excludes, for instance, investors who provide venture capital in exchange for shareholdings in AIM-listed companies, and most employees who have acquired shares in their employer's business under the various share incentive schemes. These people will now pay the new CGT rate of 28% on any realised gains above their annual allowance, an increase of 10%.

### Keep the cash in the company?

The government has said that it is committed to reducing corporation tax. This is likely to lead to a significant difference in the rates of personal taxation (income tax and CGT) and company taxation (corporation tax). As a result, it could become attractive to retain cash and investments within a company for longer, especially for businesses owned and managed by shareholding directors.

This opens up a number of options for investing cash held within a business. For instance, offshore life

### Failing the 20% test now costs more!

Following the increase in entrepreneurs' relief, is it advisable to review what owner-managed businesses and corporate clients are planning to do with their surplus cash.

Business owners who are considering disposing of the business need to consider the financial penalties of breaching the 20% test. This determines whether a business is considered to be a trading business for the purposes of entrepreneurs' relief. For instance, if the value of a company's surplus cash on deposit and other investments comprise more than 20% of its balance sheet it is unlikely to qualify. The company must meet the 20% test during the twelve months before it is sold or ceases to trade.

Before the June Budget, losing trading company status could mean paying 18% (rather than 10%) CGT on £2 million of realised gains. The cost of losing trading status was therefore £160,000 (£2 million x 8%). Now, however, with the increased entrepreneurs' relief and higher CGT rate, getting it wrong has become much more expensive. Losing entrepreneurs' relief alone can now cost £900,000 (£5 million x 18%).

It is important that clients are aware of this issue and its potential impact. Many directors may still prefer to keep surplus cash within the company where they may be able to make a better return.

insurance investment bonds could be attractive. The personal portfolio bond rules do not apply to companies. Therefore, an open architecture offshore bond can be used as a vehicle for a wide range of investments, as well as for deposits and mutual funds. A company that uses "historic cost accounting" can use a bond to defer corporation tax until, for example, it makes a withdrawal or full encashment. With corporation tax rates expected to fall, deferring the tax point could result in less corporation tax being paid.

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## Removing cash from a business tax-efficiently

How, then, can a business ensure it qualifies for entrepreneurs' relief? There appears to be a window of opportunity in 2010/2011 to remove up to £510,000 (2 x £255,000 annual allowance) from a business by making an employer's pension contribution. This is likely to be on behalf of an employee or officer who is also a shareholder in the company and who has relevant income of less than £130,000.

A company making a pension contribution in the current tax year will benefit from corporation tax relief at 28% or 21% – for the tax year 2011/12 this would fall to 27% or 20%.

However this involves negotiating the complexities of both the pension input period and the anti-forestalling legislation, which remains in place for the current tax year. The new government is currently consulting on reducing the annual allowance from April 2011, possibly to £30,000 or £45,000.

Even if the annual allowance is reduced significantly, removing funds from a company by making pension contributions could still be effective if there is more than one employee. As a result, making pension contributions will remain a useful way of removing money from a business for medium-sized businesses with several shareholding directors.

However, if a company has only one director, it is now more important than ever that the individual plans his or her exit carefully. If they are intending to use employer's pension contributions to remove funds, then small, early and often may well be the best course of action.

We thank Scottish Widows for providing the basis for this article.

## Use it while you can!

- Full, higher rate tax relief remains available for people with relevant income of less than £130,000 a year and, on a limited basis until 5 April 2011, for those with higher earnings.
- There is still unlimited potential for "ad hoc" employer contributions (up to the current 'normal' annual allowance of £255,000), where relevant income is below £130,000 in 2010/2011.
- Clearly, people with income of less than £130,000 have an even greater incentive to make larger pension contributions before April 2011.
- From 6 April 2011, people with income of £130,000 or more will qualify for some higher rate tax relief at their highest marginal rate. In some cases they may even benefit from deferring some pension contributions until then, rather than be subject to restricted tax relief above a special annual allowance of £20,000 - £30,000 in the 2010/2011 tax year.

Exit strategies and pension planning are complex areas requiring specialist advice. Truly rounded advice is often best achieved by a client's financial adviser and accountant working in close collaboration.

LighthouseCarrwood advisers are experienced in working with accountants to advise clients on issues such as tax-efficient pension planning and tax-planning.

**LighthouseCarrwood is one of the UK's leading providers of financial planning services to professional practices. We would be delighted to work with you to help your clients reduce their tax liabilities. To discuss how we could work with your firm in a way that suits you and benefits your clients and your business, please contact:**

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