



## PROPOSED REFORM OF CGT ANNOUNCED IN 2007 PBR

### Including the impact on small businesses and entrepreneurs

The government is proposing a major reform of Capital Gains Tax (CGT). For disposals of assets on or after 6<sup>th</sup> April 2008, CGT will be charged at a flat rate of 18%. This is the first time in over 40 years that the CGT system has not encouraged the building up of a business as a distinctive form of investment. We propose measures that will protect small businesses and encourage entrepreneurship without undermining the government's welcome wish to simplify the tax system.

#### Introduction

The proposal to tax capital gains at 18% is a reversal of the 1998 changes. The two guiding principles in 1998 were:

- The favourable treatment of business assets; and
- The encouragement of long-term investment (although in respect of business assets this principle has been eased).

These two principles have been overturned by the current proposal. It is of course a policy decision for government whether or not to favour business investment over private investment. Nevertheless, we think it is important to note that the CGT system has always provided at least some encouragement for business investment. In 1998 business asset taper relief built upon and replaced retirement relief, which itself had been a feature of the CGT system since 1965. This is therefore the first time since CGT was established over 40 years ago that no incentives will be available to those who have built up a business

In this briefing we are proposing changes that are aimed primarily at ensuring small businesses and entrepreneurship are not harmed by the government's understandable and welcome wish to simplify the system.

#### Who are the winners and losers?

This change will create a considerable number of winners and losers. The losers are businesses, where the headline rate of CGT on assets that are disposed of after two years has increased from 10% to 18%.

The winners appear to be holders of non-business assets, for example second homes, and particularly those who have held non-business assets for a short period, where their tax charge will fall from 40% to 18%.

#### Summary of ICAEW policy recommendations

Consideration should be given to adopting one or more of the following options:

- Deferring this proposal pending the establishment of a tax simplification committee to oversee tax simplification proposals and CGT reform in particular
- Deferring the start date from 6 April 2008 to, say, 6 April 2009 to give businesses time to plan their affairs;
- Preserving the entitlement to existing reliefs to ease the transition to a simpler system;
- A possible exemption for gains for smaller businesses to limit the effects on this key part of the UK economy; and
- A possible rebasing of CGT, for example to 31 March 2002 which would provide business certainty whilst not penalising historic long-term investment.

## Full policy recommendations

We support tax simplification and recognise that the government has had previous discussions regarding simplifying CGT and taper relief. However, we think that the proposed CGT reform announced in the 2007 Pre-Budget Report (PBR) requires more thought, in particular because simplification needs to be balanced against a number of other factors.

Further consideration needs to be given to fairness, the behavioural impact on taxpayers and in particular businesses, and more generally ensuring that the reasonable expectations of taxpayers are met. For these reasons it is important that government consults widely on proposed simplification measures.

The ICAEW believes that:

- 1. The government should establish a tax simplification committee** to oversee a comprehensive tax simplification programme, rather than proceed with this proposal in its current form. The committee should have representation from all stakeholders.
- 2. CGT reform should be one of the first projects of the new committee.** The committee should bring forward proposals and options for simplification which are then subject to wide consultation.
- 3. We urge the government to undertake a more detailed consultation** on the underlying policy and not just on the details. The proposed meetings between HMRC and interested parties to discuss the detail of this policy change are not sufficient to address some of the underlying policy concerns.
- 4. If the government continues with reform along the lines of the PBR proposals,** the reforms need to include measures to improve fairness, recognise the specific issues faced by businesses and the reasonable expectations of taxpayers. Consideration should be given to adopting one or more of the following options:
  - deferring the start date from 6 April 2008 to, say, 6 April 2009;
  - preserving the entitlement to existing reliefs;
  - a possible exemption for gains for smaller businesses; and
  - a possible rebasing of CGT, for example to 31 March 2002.

Please view the ICAEW Tax Faculty's full Tax Representation (TaxRep 69/07) on this issue for further details and a complete briefing. The TaxRep 69/07 can be found at <http://www.icaew.com/index.cfm?route=152088>

## About the ICAEW

The Institute of Chartered Accountants in England and Wales (ICAEW) works in the public interest to promote enterprise, innovation and sustainable growth in a socially responsible business environment. Our strength and knowledge are drawn from the expertise of our members who hold world class finance qualifications. They work in every sector of the economy, size of business and public body, from global company boardrooms and government departments, to high street practitioners, small businesses and charities. Their experience gives us an acute understanding of the dynamics which drive our economy from entrepreneurship and well-informed markets to efficient public services.

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