Taper Relief Can Go Down As Well As Up Over Time

by Felicity Cullen

The Finance Act 1998 introduced a new sort of relief from CGT – taper relief - which is generally regarded as a favourable relief.

In essence, taper relief operates by reducing the percentage of a chargeable gain that is actually charged to CGT to amounts ranging from 87.5% to 25% of the gain on a "business asset" and from 95% to 60% of the gain on a "non-business asset". (The meaning of "business asset" and "non-business asset" is by now familiar to readers but will be referred to in a little more detail below.)

The size of the percentage reduction in the chargeable gain increases with time: the maximum reduction for business assets is, for disposals since 6 April 2000, reached after four whole years and for non-business assets after ten whole years.

If the percentage reduction in a gain is translated into effective rates of tax, one sees that the rate of CGT on business assets is reduced to 10% after 4 years and on non-business assets to 24% after 10 years (see the table in s.2A TCGA 1992).

More specifically, taper relief applies to "chargeable gains which are eligible for taper relief" (s.2A(3) TCGA 1992). A gain is defined as eligible

for taper relief if either "it is a gain on the disposal of a business asset with a qualifying holding period of at least one year" or "it is a gain on the disposal of a non-business asset with a qualifying holding period of at least three years" (s. 2A(3)(a) and (b) TCGA 1992).

As a matter of mechanics, taper relief is applied by multiplying the amount of a gain on a disposal by a percentage specified in the table set out in s. 2A(5) TCGA 1992, the percentage being that set opposite the number representing the number of whole years for which an asset has been held.

The period for which an asset has been held is known as the "qualifying holding period" (referred to above) and is defined in s. 2A(8) TCGA 1992.

For disposals on or after 6 April 2000 the qualifying holding period is defined as follows:-

> "(8)(a) in the case of a business asset, the period after 5 April 1998 for which the asset has been held at the time of its disposal;
>
> (b) in the case of a non-business asset where –
>
> (i) the time which, for the purpose of paragraph 2 of Schedule A1 is the time when the asset is taken to have been acquired by the person making the disposal is a time before 17 March 1998, and
>
> (ii) there is no period which by virtue of paragraphs 11 or 12 of that Schedule does not count for the purpose of taper relief, [these paragraphs contain anti-avoidance provisions which can disqualify certain periods of ownership from counting towards the qualifying period], the period mentioned in paragraph (a) plus one year;
>
> (c) in the case of any other non-business asset, the period mentioned in paragraph (a)."

These periods are made subject to reduction by anti-avoidance provisions in Schedule A1 TCGA 1992 which contains most of the detailed rules relating to taper relief (and to rules disqualifying periods where shares potentially eligible for taper relief have qualified for enterprise investment scheme relief: para.4 Schedule 5BA TCGA 1992).

For disposals before 6 April 2000 the qualifying period was essentially the same as it is for later periods except that business assets also benefited from the so-called bonus year. At the same time as the acceleration of the effective rate of taper relief in FA 2000, the bonus year was removed for business assets.

Periods of Ownership and Use of Assets

As seen, the amount of taper relief available on the disposal of an asset (i.e. the extent of the percentage reduction in a chargeable gain) is calculated by reference to the "qualifying holding period" of that asset (s.2A TCGA 1992).

Schedule A1 TCGA 1992 contains references to the qualifying holding period of an asset but also contains the definition and applies the concept of "relevant period of ownership" of an asset.

The relevant period of ownership is defined in para.2(2) of Schedule A1 as whichever is the *shorter* of –

> "(a) the period after 5 April 1998 for which the asset has been held at the time of its disposal; and
>
> (b) the period of ten years ending with that time."

The expression "the period after 5 April 1998 for which the asset had been held at the time of its disposal" is itself defined in para.2(1) Schedule A1 as the period which:

> "(a) begins with whichever is the later of 6 April 1998 and the time when the asset disposed of was acquired by the person making the disposal; and
>
> (b) ends with the time of the disposal on which the gain accrued."

Until 5 April 2008 the relevant period of ownership of all assets will be less than or equal to the ten year maximum; it will be the actual period of ownership (up to a maximum of ten years) for assets acquired after 5 April 1998 and the period from 6 April 1998 to the date of disposal (up to a maximum of ten years) for assets acquired before that date.

After 6 April 2008 the relevant period of ownership of all assets will be the actual period of ownership up to a maximum of ten years before the date of the disposal of the asset.

The significance of the "relevant period of ownership" of an asset is that it is the period by reference to which the nature of the asset as either a business or non-business asset is determined for taper relief purposes. Whether or not an asset is a business or a non-business asset for taper relief purposes depends upon whether it is an eligible holding of shares (including securities) in a

"qualifying company" or, in relation to assets other than shares the quality of its use. In essence, eligible holdings of shares and assets used for the purposes of trades, professions, vocations or employments will be business assets: other assets will be non-business assets: see paras.4 – 8 of Schedule A1.

The distinction must be made between the "qualifying holding period" of an asset, which will effectively determine the *rate* of taper relief available, and the "relevant period of ownership" of an asset which is used as the period by reference to which the nature of an asset is tested.

When taper relief was first introduced in 1998, the maximum duration of both periods (qualifying holding period and relevant period of ownership) was ten years, so that the two periods essentially coincided. Since the reduction (in the current Finance Bill) of the maximum qualifying holding period for business assets from ten to four years, however, the qualifying holding period of an asset and the relevant period of ownership of that asset will not always coincide.

Subject to the application of anti-avoidance provisions, where an asset has been a business asset *throughout* its relevant period of ownership a chargeable gain accruing to the person disposing of it is a "gain on the disposal of a business asset" (para.3(1) Schedule A1). The effect of a gain being a "gain on the disposal of a business asset" is that it is eligible for taper relief at rates applicable to business assets determined by the qualifying holding period of the asset (s.2A(3) – (5) TCGA 1992). A gain or any part of a gain arising on the

disposal of an asset that is not a gain on the disposal of a business asset is treated as a gain on the disposal of a non-business asset and is eligible for taper relief at the lower rates prescribed in s.2A TCGA 1992.

The taper relief rules recognises that the nature of an asset (as a business or a non-business asset) may change during the course of its relevant period of ownership and deal with this by treating the gain on an asset that has been both a business and a non-business asset throughout the relevant period of ownership as, in part, a gain on the disposal of a business asset and as to the remainder, a gain on the disposal of a non-business asset: para.3(2) Schedule A1.

Where para.3(2) Schedule A1 applies, the gain is divided into a gain on the disposal of a business asset and a gain on the disposal of a non-business asset. This division is done on a time apportionment basis by reference to the relative periods of the asset's nature as a business and non-business asset throughout the relevant period of ownership: para.3(3) Schedule A1. (In effecting this time apportionment, account is taken of paras.8 and 9 of Schedule A1 which deal with the nature of assets in certain settlements and periods where there is mixed use of assets such that an asset is both a business and non-business asset at the same time in the relevant period of ownership.)

It should be borne in mind that sub-paras.3(2) and (3) Schedule A1 deal with the proportions of the gain that are to be respectively treated as gains on the disposal of business and non-business assets. They do not split the relevant

period of ownership: they impact upon figures rather than periods. This is emphasised in para.3(5)(b) Schedule A1 which prescribes how "mixed" gains are to be treated for taper relief purposes.

Para.3(5) Schedule A1 provides that where a gain on the disposal of a business asset accrues on the same disposal as a gain on the disposal of a non-business asset (i.e. where an asset has been both a business asset and a non-business asset during its relevant period of ownership) –

> "(a) the two gains shall be treated for the purposes of taper relief as separate gains accruing on separate disposals of separate assets; but
>
> (b) the periods after 5 April 1998 for which each of the assets shall be taken to have been held at the time of this disposal shall be the same and shall be determined without reference to the length of the periods mentioned in sub-paragraph (3)(a) and (b) above."

The effect of paragraph 3(5) Schedule A1 is that the two elements of what, in reality, is a single gain are treated as gains on separate assets for taper relief purposes which will, in particular, be relevant for the purposes of calculating the rate of relief given under s.2A TCGA 1992; and both gains are treated as accruing on an asset that has been held throughout the single, relevant period of ownership rather than for the period corresponding to the nature of the gain used in dividing the gain in monetary terms under para.3(2) and (3), Schedule A1.

For example, if an asset has been held for a total of ten years since 6 April 1998 before disposal, it will have a relevant period of ownership of 10 years. If

it has been a business asset for the last 6 of those 10 years and a non-business asset for the first 4, 3/5ths of the monetary gain on its disposal will be a gain on the disposal of a business asset and 2/5ths will be a gain on the disposal of a non-business asset. Each amount of gain of the respective natures (i.e. gain on the disposal of business and non-business assets) will be treated as a gain accruing on the disposal of an asset with a relevant period of ownership of 10 years.

If this example is continued with and related back to qualifying holding periods and rates of taper relief, the effect seems surprising. Because of the difference between the relevant period of ownership and the qualifying holding period of an asset eligible for taper relief at the business asset rate, only 3/5ths of the gain will be eligible for taper relief at the business asset rate. The remaining 2/5ths of the gain will be eligible for relief at the non-business asset rate.

This is a surprising result because, following the changes in the Finance Bill, one would expect an asset which has been a business asset for more than the last four years of ownership to be eligible for taper relief at the business rate on the full gain.

It may be thought that the effects of this point will not be wide-ranging, but given the extended class of assets eligible for taper relief at the business assets rate, examples of the anomaly may occur more often than may be expected - at least in the case of shares and securities as distinct from other

assets which may be eligible for relief under para.5 Schedule A1 (i.e. assets used for the purposes of trades, professions, vocations or employments).

Examples of where the point may arise are as follows.

(a) Suppose an individual has held shares in a trading company which gave him fewer than 5% of the voting rights since April 1998. Those shares would have been a non-business asset for periods up to 5 April 2000, but following the changes in FA 2000, a business asset since 6 April 2000.

The individual's taper relief will be given on the basis that the shares have been an asset of mixed nature, and if he were to dispose of them in May 2004, only 2/3rds of his gain would be eligible for taper relief at the full business asset rate. The individual would have to wait until after 5 April 2010 before he could dispose of the shares with all of the gains being eligible for relief at the full business asset rate.

(b) Suppose an employee has owned a holding of shares giving him fewer than 5% of the voting rights in his employer company since April 1998. Those shares will be a non-business asset for the period 6 April 1998 to 5 April 2000 and a business asset after 6 April 2000. Again, therefore, taper relief would be given on the basis that part of the gain were a gain on the disposal of a business asset and part of the gain were the disposal of a non-business asset.

It follows that an employee who acquired shares in 1998 would have to wait until 2010 before getting taper relief in full at the business assets rate, whereas an employee acquiring shares since 6 April 2000 could sell and obtain full taper relief at the business assets rate four years after acquisition.

(c) Similar consequences would follow where an employee who held a similar number of shares in his employer company as a business asset ceased to be employed, but continued to hold the shares so that they changed from being a business asset to being a non-business asset. This change of status would arise as a result of the new definition of business assets in clause 66 of the Finance Bill under which a company is to be taken to have been a qualifying company by reference to an individual at any time where "the individual was an officer or employee of the company, or of a company having a relevant connection with it."

In the cases of employees who cease employment and continue to hold shares in the employer company the rate of taper relief available will reduce over time so that there is a disincentive to retaining the investment in the former employer.

(d) Any holding of shares in an unquoted trading company will, from 6 April 2000, be a business asset for taper relief purposes. Where the shares were held before 6 April 2000 they will often be an asset both of a non-business and a business nature for taper relief purposes, generally a non-

business asset before 6 April 2000 and a business asset after that time. Again, therefore, maximum taper relief at the business asset rate will only be achieved after 5 April 2010.

If such an unquoted company becomes quoted and there were no other circumstances causing a holding of shares to be a business asset in relation to a given shareholder (e.g. 5% voting rights), the shares would again become non-business assets with a progressive reduction in the rate of taper relief. As with the case of retiring employee shareholders, there would be a disincentive to retaining the investment following the quotation of shares and the start of the reduction in taper relief.

These issues could become further complicated by share identification rules which may not enable a person to sell shares in such a sequence as to maximise the amount of taper relief available to him. The position could be further aggravated in circumstances where employee shareholders acquire shares by successive exercises of options; these shareholders are unlikely to be helped by para.13 Schedule A1 which, in essence, deems acquisition and disposal dates to relate to exercises of options rather than grants.

It may be that these anomalies result from an oversight and were not intended.

Many of them were, however, identified at the Committee Stage of the Finance Bill and proposed amendments to the Bill were tabled. The

Government, however, refused to accept the amendments on the basis that the changes to taper relief were intended to be only for future benefit and in no sense retrospective. This reaction does not answer some of the anomalies which will occur; but until the qualifying holding period and the relevant period of ownership are brought into line and some sort of election can be made to "freeze" taper relief once the maximum level has been obtained, the consequences or potential consequences of these amendments will have to be borne very much in mind.

FELICITY CULLEN

GRAY'S INN TAX CHAMBERS