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A Sting in the Tail for Entrepreneurs

The Emergency Budget appeared good news for business owners selling their trading companies despite the new 28% Capital Gains Tax rate. The lifetime limit for Entrepreneurs Relief (ER) was increased and gains on qualifying disposals up to £5 million now attract the favourable 10% tax rate.

However, there was also an unwelcome change to the taxation of Qualifying Corporate Bonds (QCBs) which applies to company share sales completed before and after 22 June. QCBs are a common feature of business sale/purchase transactions where part of the purchase price is satisfied in the future by redeemable loan notes. Capital gains arising on shares sold in exchange for QCBs are 'frozen' until the QCBs are redeemed.

Prior to 23 June, provided the conditions for ER were satisfied at the time the deal was completed ER would also apply to the QCBs when they were later redeemed, giving a tax rate of 10%. However ER will no longer be available in these circumstances unless the vendor has been a director/employee owning 5% of the ordinary share capital/voting rights for 12 months at the point the QCBs are redeemed.

For company sales completing after the Emergency Budget involving QCBs, in most cases tax will be payable at the new rate of 28% when the QCBs are redeemed.

It is possible to opt to tax the capital gains at the point of completion to avoid losing ER although this means paying the tax early, and potentially at a time when it is not known whether the QCBs will actually be redeemed in future. If the purchaser subsequently defaults on the QCBs, there is no mechanism to recover the tax paid previously.

For sales completed prior to 23 June 2010 but where QCBs are redeemed after this date transitional rules result in a tax rate of 15.5%, as opposed to the 10% rate which would be expected.

Those involved in current or previous transactions involving QCBs should consider the impact of this change in the rules.

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