

The Taxing Wealth Report 2024

Every politician's guide to
"How to pay for it"

Capital gains tax reform: Abolishing entrepreneur's relief

Brief summary

This note suggests that:

- Capital gains tax business asset disposal relief, which is still popularly known as entrepreneur's relief, should be abolished.
- This relief does at present offer a 10% tax rate on the first £1 million of gains made by a person during their lifetime when disposing of relevant business assets, which will usually be an interest in a private business.
- The relief is claimed by relatively few people a year and the vast majority of the relief by value usually goes to a relatively small number of claimants. In 2020 just 4,000 claimants enjoyed 73 per cent of the total relief provided by value.
- The relief makes no economic sense. It does not encourage entrepreneurial activity because it provides relief when a business is sold i.e., when the person making the claim has ceased entrepreneurial activity. As a result, the relief does not encourage entrepreneurial activity but does instead encourage short-termism within the UK economy. This is sufficient in itself to justify abolition of this relief.
- HM Revenue & Customs estimate that at current rates of capital gains tax this relief now costs £1.1 billion per annum. However, this report suggests that current capital gains tax rates be abolished and that capital gains should be taxed at in

¹ This note forms a part of 'The Taxing Wealth Report 2024' published by Finance for the Future LLP, which is UK LLP number OC329502, registered at 33 Kingsley Walk, Ely, Cambridgeshire, CB6 3BZ. See <https://www.financeforthefuture.com/taxing-wealth/>. This note was written by Richard Murphy FAcSS FCA FAIA (Hon), Professor of Accounting Practice, Sheffield University Management School, who is a director of Finance for the Future LLP. © Finance for the Future 2023.

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come tax rates. That is likely to increase the cost of this relief, and so the amount that might be saved by its abolition, to approximately £2.2 billion per annum.

<p>The proposal</p>	<p>To abolish entrepreneur’s relief within UK capital gains tax.</p>
<p>Reason for the proposal</p>	<ol style="list-style-type: none"> 1. To improve the horizontal equity of taxation, which is currently undermined by the availability of capital gains tax entrepreneur’s relief. 2. To increase the prospect of vertical equity of taxation in the UK which is heavily dependent upon the creation of improved horizontal tax equity. 3. To reduce the tax spillover effect that having entrepreneur’s relief within capital gains tax creates. 4. To reduce the rate of tax avoidance in the UK which this relief encourages. 5. To consequently improve the rate of tax compliance in the UK². 6. To raise additional sums in additional tax revenues. 7. To reduce wealth inequality in the UK which capital gains tax entrepreneur’s relief increases.
<p>Estimated tax that might be raised as a result of the recommendation made</p>	<p>The behavioural response to this recommendation cannot be known but is likely to be beneficial by encouraging longer term business development before disposals take place. The impact on tax yields might also be beneficial in that case as gains might be larger if business assets are held for longer.</p> <p>The current estimated cost of this tax relief provided by HM Revenue & Customs is £1.1billion per annum, but that estimate assumes that the applicable tax rate is 20%.</p>

² Many of the terms used in this summary are explained in more depth at <https://www.taxresearch.org.uk/Blog/2023/09/07/the-taxing-wealth-report-2024-methodology/>

	If that tax rate was increased to a person's marginal income tax rate the amount that might be raised by abolishing this allowance might increase to £2.2 billion a year.
Ease of implementation	Simple. The sum relieved was reduced without difficulty in 2020.
Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required.	Short.

Background

Capital gains tax was introduced in the UK in 1965. As was made clear by the Rt Hon James Callaghan MP, the Chancellor of the Exchequer at the time, the aim was to ensure that income could not be recategorised as capital gains and so escape from either the income tax system or fall out of taxation altogether. The tax was as a consequence always as much an anti-avoidance measure as it was a revenue-raising tax.

The tax rate in operation from April 2020 to April 2024 have been as follows:

	From 6 April 2023	From 6 April 2020 to 5 April 2023
Standard rate (basic rate taxpayers)	10% / 18%	10% / 18%
Higher rate (higher and additional rate taxpayers)	20% / 28%	20% / 28%
Business asset disposal relief (Entrepreneur's relief) effective rate	10%	10%
Annual exemption:		
Individual	£6,000	£12,300
Trusts	£3,000	£6,150

Where two rates are shown the first refers to gains in general and the second to gains on the sale of land and buildings.

Other proposals in this report address the rates of tax at which capital gains are charged and the appropriate rate of annual exemption that should be available for the purposes of this tax, suggesting changes in both. The current recommendation relates solely to the abolition of what is technically called business asset disposal relief, but which is however still popularly known as entrepreneur's relief.

Entrepreneur's relief was introduced by a Labour government in 2008. It announced in the Budget documents for that year³ that:

A new entrepreneurs' relief will also be available on the disposal of a trading business or shares in a trading company, provided the seller is an officer or employee of the company and has a minimum 5 per cent stake in the business. This will reduce the effective tax rate to 10 per cent for up to the first £1 million of gains made over a lifetime.

The lifetime limit on qualifying gains was raised to £2 million in the March 2010 budget. It was increased again just three months later, to £5 million by the new Conservative/Liberal coalition government and yet again in 2011 to £10m. In the March 2020 budget, the lifetime allowance for this relief was reduced to £1m and the relief was renamed to Business Asset Disposal Relief but otherwise little changed.

In 2023 HM Revenue & Customs estimated⁴ that this tax relief cost £1.1 billion a year, a reduction from £2.8 billion in 2020 before the lifetime limit was cut.

The recommendation

It is recommended that this relief be eliminated.

In 2023 HM Revenue & Customs estimated that the relief was likely to be claimed by 47,000 people in that year, at most. Each claimant would, in that case, benefit by £23,400. However, in 2020 it was noted⁵ that data then current showed that the total cost of the relief was £2.36 billion per annum but of this £1.73 billion went to just 4,000 people giving them a tax savings of more than £430,000 each, on average. It remains very likely that the

³ <https://www.gov.uk/government/publications/budget-2008-stability-and-opportunity-building>

⁴ [https://www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs/non-structural-tax-relief-statistics-january-2023#:~:text=NICs%20\(estimated%20at%20%C2%A324.7%20billion%20in%202021%20to%202022\)](https://www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs/non-structural-tax-relief-statistics-january-2023#:~:text=NICs%20(estimated%20at%20%C2%A324.7%20billion%20in%202021%20to%202022))

⁵ <https://www.taxresearch.org.uk/Blog/2020/02/10/entrepreneurs-relief-an-exercise-in-the-tax-system-redistributing-wealth-upwards/comment-page-1/>

distribution of the benefit of this relief remains as skewed in favour of a small number of claimants.

The impact of the relief is to provide a boost to the wealth of the already wealthy. Anyone claiming it has, after all, already made a significant capital gain that is, in effect, delayed payment for the work they have undertaken for a company in which they have been involved. Not only is this horizontally inequitable in tax terms, it also makes no economic sense. That is because the relief does nothing to encourage entrepreneurial activity because it provides a tax saving when a person ceases to undertake entrepreneurial activity by selling a company rather than when they commence it, which is when entrepreneurial activity occurs. The entire logic underpinning the relief is, in that case, illogical.

What this relief actually encourages is short-termism and an inclination to sell out from an activity rather than to develop it, both of which are the opposite of what the UK needs. As such this relief should be abolished.

The estimated cost of this relief provided by HM Revenue & Customs assumes existing tax rates, which would charge a maximum of 20% on gains of the sort subject to Business Asset Disposal Relief. Increasing rates to income tax levels, as recommended in this report, would at least double the cost of this relief. That means that abolishing it might save £2.2 billion a year.