



Capital gains tax *update*

The first Budget presented by George Osborne for the new Coalition Government announced major changes to the capital gains tax (CGT) regime. Whilst changes were discussed before the Budget we could not be sure when these would apply and what these would entail.

The major headline was a new rate of CGT of 28% which was introduced with effect from 23 June 2010. For individuals the CGT rate will remain at 18% where total taxable gains and income are less than the upper limit of the income tax basic rate band. The 28% rate will apply to any excess.

For a higher rate tax payer with a capital gain of £100,000 arising on or after 23 June 2010 this could see the tax bill rise by more than 55 percent from £16,182 to £25,172. The focus of this guide is to explore the various aspects of CGT and how tax planning can substantially improve your future CGT position.

WHAT IS CGT AND WHEN IS IT DUE?

CGT is a tax chargeable on the profit or gain you make when you sell or 'dispose of' an asset. The disposal of an asset not only includes a sale but also when you:

- *give it away as a gift*
- *transfer it to someone else*
- *exchange it for something else*
- *receive compensation for it (e.g. the receipt for an insurance payout when an asset has been destroyed)*

Thus you do not have to receive any consideration for the disposal in order to have a CGT liability. To highlight the effect of this broad definition of a disposal, note that the gift of a rental property to a sibling for nil consideration would still be deemed as a disposal for CGT with the proceeds deemed to be at market value at the date of the gift.

CGT is chargeable on world-wide gains from asset disposals by individuals who are resident or ordinarily resident in the UK. The tax is payable on or before 31 January following the tax year of disposal. Nevertheless, there are a number of ways to mitigate, eliminate or defer a capital gain and the earlier plans are put in place the more options are available.

SO, WHAT RELIEFS AND OPTIONS ARE AVAILABLE TO ME?

1. Making use of available exemptions...

Use of annual exemptions

Most UK taxpayers have an annual CGT exemption of £10,100 (2010/11). Annual gains of up to the CGT exemption are free of tax but these cannot be accumulated or carried forward. Where possible these exemptions can be utilised to split disposals split between tax years.

Exempt assets and chattel exemption

Certain types of assets are exempt from CGT upon sale. These assets include cars, betting and lottery winnings, UK government or 'gilt-edged' securities (e.g. national savings certificates, premium bonds), depreciating assets such as racehorses and 'chattels' bought and sold for under £6,000 (e.g. personal possessions such as jewellery or paintings). Chattels that are bought for less than £6,000 but sold for more (or vice-versa) are not wholly exempt but qualify for special reliefs to reduce the effective rate of tax. Making use of the capital gains free status of ISAs within the prescribed limits can also be an effective CGT mitigation tool.

Husband and wife transfers

All transfers between a husband and wife or those in a civil partnership are treated as occurring at no gain / no loss. As a result, if the taxpayer has already used up their CGT annual exemption but their spouse or civil partner has not, they could still save tax by transferring an asset to their spouse prior to sale so that the gains are assessed on them for CGT purposes.

2. Making use of various reliefs...

There are various reliefs available which can be used to eliminate, mitigate or defer CGT. Fundamental to the CGT calculation is determining whether you are disposing of a business or non-business asset. Business assets in the main will benefit from the lower CGT rate from entrepreneurs' relief, and from a range of tax reliefs. Entrepreneurs' relief, rollover relief and holdover relief may all be available where the disposal is considered a business asset for CGT.

Entrepreneurs' relief reduces the amount of gain liable to CGT and any gains qualifying for entrepreneurs' relief are taxed at an effective rate of only 10 percent, in contrast to the full rate of 18% or 28%. The June Budget produced a major change to this relief as the lifetime allowance on qualifying gains increases from £2 million to £5 million from 23 June 2010. Claims for the relief can be made on more than one occasion, and it is possible for an entrepreneur that has made a qualifying gain of £2 million before 23 June 2010 to make a further qualifying gain of £3 million on or after 23 June 2010 on a further disposal and take advantage of the increase in the lifetime limit.

Rollover relief is available where you dispose of a business asset but the proceeds are re-invested into a replacement business asset either within one year before the disposal or three years after the disposal. In this scenario, the liability to CGT is deferred until the disposal of the newly acquired asset. Where not all of the proceeds are re-invested the relief is restricted, although it may be advantageous to reduce the elected proceeds in order to utilise any available annual CGT exemption.

Holdover relief is available where a business asset is given away and allows the gain to be 'held over' or postponed. The person you have gifted the asset is treated as having acquired the asset at the original cost price and the tax is payable by the transferee when they eventually dispose of the asset in the future. If partial consideration is received for the gift, you will need to ascertain if any CGT is due.

Deferral relief involves the re-investment of the gain into an Enterprise Investment Scheme (EIS) registered company. The gain is deferred until the future disposal of the EIS shares. The conditions regarding this relief are less onerous as the asset disposed of in establishing the gain does not have to be a business asset and only £1 of re-investment is required to defer £1 of gain (unlike rollover relief). Additionally, it may be possible that the deferral can be achieved by re-investing into an unquoted trading company controlled by the taxpayer.

Principal private residence (PPR) relief or main residence relief is an exemption from CGT on all or part of the disposal of a property that was at some time occupied by the taxpayer as their main residence. Controversially used by some MP's in the expenses scandal, the process of 'flipping' is involved where a taxpayer makes an election to change their nominated PPR to benefit from the tax breaks and subsequently changes it back again. Any property that has qualified for PPR relief will generally mean the last 36 months of ownership are exempt from CGT, regardless of the length of time the property was the nominated PPR. It is important that professional advice is sought surrounding this area as not only are there potentially additional benefits available where a valid PPR election is made but also numerous restrictions apply. For example, where part of the PPR has been used for business purposes relief may be restricted and husbands and wives and civil partners can only make one PPR election between them.

3. Other structures and options...

Capital Losses

The use of current year or brought forward capital losses are also a key aspect to reducing exposure to CGT. This may provide a planning

opportunity so that losses are used against assets subject to a higher rate of CGT or seeing if it is possible to crystallise the "paper loss" on an equity investment by submitting a negligible value claim rather than by through an actual sale. Of course, in an ideal world a taxpayer will not hold assets which produce a loss.

Trusts and Pension Funds

Trusts and pension funds can be a useful tool in minimising CGT. The transfer of an asset into the majority of trusts is treated as being at market value for CGT purposes and may allow CGT to be crystallised at the current rate. The trustees are deemed to have acquired the asset at current market value which is then their base cost used for a future sale taxed at the new higher rates. Trusts may also be used to defer incurring a charge to CGT. Assets that have gained in value since they were purchased can be transferred into a trust and providing the trust allows a holdover claim then the CGT charge can be deferred. The ability to holdover the gain of a non-business asset makes this a popular option for taxpayers. Pension funds are another vehicle that can be used to hold certain assets which shelter them from CGT. Any growth in the capital value of an asset in a pension fund is not subject to CGT. If the asset has been purchased with retirement in mind then this may be a very viable and tax efficient option.

Non-Residency

For the more mobile, consideration could be made with respect to emigrating overseas and becoming non-resident, for UK capital gains tax purposes. Subject to strict conditions, this may allow all the gains made on UK assets to be tax-free. It is important to note that recent developments with respect to case law and conditions surrounding non-residency makes it essential professional advice is sought before embarking on such a tax mitigation scheme.

Miscellaneous

There are a variety of other options available with respect to CGT planning. These options may include investment into venture capital trusts and enterprise investment schemes which benefit from CGT fee growth providing strict conditions are met. Alternatively, restructuring the asset held can be particularly useful within areas of corporate finance, where equities can be exchanged for loan notes. The loan notes can be redeemed over a number of years, utilising more than one year's worth of annual exemption.

Overall there are a wide spectrum of reliefs and options available with respect to CGT planning. As with all good tax planning advice, it is absolutely critical that the specific facts surrounding your personal circumstances are obtained. Certain actions with respect to CGT may have consequences with respect to other taxes (e.g. inheritance tax or stamp taxes). With the continuous changes in legislation and progression of case law, we strongly encourage you to consult your professional advisor and review your CGT position in advance of making any decisions.