

Outline of Capital Gains Tax

Introduction

Capital Gains Tax (CGT) was introduced in 1965 to supplement the Income Tax regime. The intention is to tax the profit made on the disposal of a capital asset in cases where an Income Tax charge does not apply.

Scope of CGT

If an individual is tax resident or ordinarily resident in the United Kingdom, CGT applies to all his or her property wherever it is situated (subject to any double tax relief). If an individual is neither resident nor ordinarily resident in the UK, they are not subject to CGT even on the disposal of UK assets.

If the individual is domiciled abroad, capital gains on overseas assets may only be taxed if the proceeds are remitted to the UK, but complicated rules apply.

Individuals, trustees and business partners are liable to CGT. Companies pay Corporation Tax, which embodies some of the principles of CGT.

Basic Principles

CGT is charged on the increase in the value of a chargeable asset between when it is acquired and when it is disposed of, subject to various exemptions and reliefs. If the value falls, the resulting loss made on disposal may be available to set against capital gains made by the same taxpayer in the same or subsequent tax years. However, the use of some losses are restricted or disallowed altogether.

The disposal of an asset includes its sale or gift and where insurance is paid for damage or destruction.

The costs of acquiring, enhancing (but not just maintaining or repairing), protecting and transferring an asset are deductible from the gain before CGT is assessed. Inherited assets are acquired at probate value.

Assets acquired before 31 March 1982 are deemed to have been sold and immediately reacquired at market value on that date, so taking any earlier changes in value out of account for CGT.

Chargeable Assets

Most types of asset are liable to CGT, including freehold or leasehold property (other than the only or main residence), shares, legal rights (including options), goodwill and foreign currency.

The following are not liable to CGT:

- 1 Government Stock and many corporate bonds;
- 2 National Savings Certificates and Premium Bonds;
- 3 ISAs;
- 4 motor cars and other wasting assets with a life expectancy of not more than 50 years;
- 5 non-wasting chattels (e.g. jewellery and antiques) worth less than £6,000;
- 6 life policies (unless bought by another);
- 7 a taxpayer's only or main residence.

Losses on non-chargeable assets cannot be set against capital gains on chargeable assets.

Head Office

3 Lonsdale Gardens
Tunbridge Wells
Kent TN1 1NX
T 01892 510000
F 01892 549884

Thames Gateway

The Old Rectory
St. Mary's Road
Greenhithe
Kent DA9 9AS
T 01322 623700
F 01322 623701

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Disposal Value

In a bargain made at arm's length between unconnected persons, the value on disposal will be the sale price.

Disposals between spouses* who are living together are treated as if neither a gain nor a loss arises, even if money changes hands.

Any disposal which is not made at arm's length is treated as if it is for the then market value of the asset. This applies to gifts, sales at an undervalue and to transactions between connected persons. They include spouses, siblings, ancestors or descendants in the blood line, and business partners and their spouses and relatives (other than in bona fide commercial arrangements between partners). Losses made on a disposal to a connected person can only be set against gains made on a subsequent transaction between the same connected parties.

Timing of Disposal

The disposal will normally be the date of the sale, gift or other event. A disposal by contract will be when the contract is unconditional, rather than on subsequent completion. Special rules apply to options.

Calculation of CGT

Gains realised from 6 April to 22 June 2010 are taxed at a flat rate of 18%. For an individual, gains arising on or after 23 June 2010 must be added to his or her taxable income. Gains falling within the individual's basic rate Income Tax band are liable to CGT at 18%, with any excess taxable at

28%. Trustees and personal representatives are assessed to CGT at a flat rate of 28% on post-22 June 2010 gains.

A reduced rate of CGT is payable on the disposal of some business assets - see entrepreneurs relief below.

Annual Exemption

Individuals each have an annual exemption for chargeable gains, being £10,600 for tax year 2011/12. It cannot be carried forward or back and is not transferable between spouses.

Personal representatives of an estate have the full exemption for the tax year of death and the following two tax years, but no exemption subsequently.

Trustees have an annual exemption of up to one half of the individual's exemption, but sub-divided between the number of trusts made by the same person since 6 June 1978.

Available losses realised in the same tax year have to be deducted from capital gains before the annual exemption is applied. However, losses carried forward from previous tax years can be used to reduce the subsequent gains only to the level of the annual exemption.

Payment Dates

CGT is usually payable by 31 January following the end of the tax year in which chargeable gains are made.

CGT can, however, be paid by instalments

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in two situations, subject to interest. First, over ten years on an outright gift of land, a controlling shareholding, or a minority shareholding in an unquoted company. Secondly, over up to eight years if the price for the disposal is payable in instalments exceeding 18 months.

Anti-avoidance

There are various statutory provisions intended to avoid the taxation of capital profit as opposed to income. These mostly relate to transactions in land (including premiums for leases) and in securities.

Business reliefs

Various reliefs apply to reduce or to postpone the impact of CGT on business interests, including:

1 Entrepreneurs relief

This has replaced the previous taper and indexation reliefs since 6 April 2008.

Entrepreneurs relief from 6 April 2011 reduces the rate of CGT to 10% for up to £10,000,000 of gains on one or more disposals during lifetime of (a) some or all of a trading business (b) assets formerly used in the business following cessation of trading or (c) shares in a trading company if the taxpayer is an officer or employee and holds 5% or more of the shares with voting rights.

The lifetime limit was lower previously and there can be no carry back of the increased relief to disposals before 6 April 2011.

2 Replacement roll-over relief

CGT can be postponed on the replacement of business assets which are sold to the extent that, within one year before and three years after disposal, the sale proceeds are reinvested in qualifying replacement business assets. They include land, buildings, plant and machinery and goodwill.

3 Incorporation roll-over relief

Again, CGT can be postponed where an unincorporated business (other than an unincorporated association) is transferred to a company in return for shares.

Gifts

Gifts and other transactions not at arm's length are treated as disposals at open market value. This rule does not apply to transfers between spouses.

Gifts will also have Inheritance Tax (IHT) implications, which need to be considered.

It is possible to postpone CGT on gifts by electing for hold-over relief in the circumstances mentioned below. This avoids an immediate CGT charge for the donor and involves the donee taking over the donor's CGT base cost.

1 Business assets hold-over relief

The CGT can be deferred on the disposal of an asset or interest in it used for a business or on the disposal of shares in an unquoted trading company (including AIM shares) or shares in a quoted trading company in which the individual holds at least 5% of the voting rights. The relief can also be claimed

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for land eligible for IHT Agricultural Property Relief.

If the whole of a gain is either rolled over or held over, entrepreneur's relief will not apply. However, on a gift the gain does not have to be held over and entrepreneur's relief can be obtained, albeit with an immediate CGT liability.

2 Non-business assets hold-over relief

CGT may be postponed if the gift is a chargeable transfer for IHT. This will apply to most transfers into a trust and some transfers by trustees out of a trust. However, hold-over relief cannot be claimed on outright gifts or other potentially exempt transfers for IHT.

Neither type of hold-over relief is available if the donee is neither resident nor ordinarily resident in the UK for tax purposes. Furthermore, relief cannot be claimed on the transfer to a settlement if the settlor, their spouse or any unmarried minor child or step-child can benefit from the settlement. In addition, following a claim for non-business hold-over relief for property, there can be no only or main residence relief for CGT for the donee subsequently.

Death

On death there is a tax free uplift in the deceased's base value for CGT. The executors and beneficiaries will take on the assets at probate value. If that value is ascertained for IHT, it will be binding for CGT, but otherwise the probate value will have to be agreed for CGT when there is a subsequent disposal.

Deed of Variation

As with IHT, the variation by the beneficiary of an estate within two years of the death may for certain CGT purposes be treated as if the deceased had made it. Further details are available in the information sheet Deeds of Variation.

Trusts

Because the settlor is a connected person with the trustees, any transfer between them will be treated as otherwise than by way of bargain at arm's length. Unless hold-over relief (see above) is available and is claimed, the settlor will face a CGT liability when transferring chargeable assets at a gain to trustees.

The trustees are assessed to CGT on the actual disposal by them of chargeable assets. They may also be regarded as making a disposal when one or more beneficiaries become entitled outright to assets, either following the exercise of a discretion given to the trustees or under the terms of the trust. On the death of a life tenant, there may be a tax free uplift in the base value of the trustees' chargeable assets, but this will not necessarily be the case following the major changes to IHT made in 2006.

For trustees who are non-resident in the UK for tax purposes, and so who are outside the UK tax net, special rules apply to attribute their capital gains either to the settlor or, failing that, to beneficiaries who receive assets or other capital payments from the non-resident trust. These rules still apply where a non-resident trust is imported to the UK by the appointment of UK-resident trustees.

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Shareholders

If shares in a holding have been acquired at different times, "pooling" rules apply when some of them are subsequently disposed of in order to identify the relevant base value.

If a company makes capital distributions to its shareholders, they will be treated as disposing of some or all of their shares for CGT. This will include repayments of share capital and distributions on the winding up of a company.

Disclaimer

This information sheet is written as a general guide. As any course of action must depend on your individual circumstances, you are strongly recommended to obtain specific professional advice before you proceed. We do not accept any responsibility for action which may be taken as a result of having read this information sheet.

NOTE: The law is stated as at 6 April 2011.

If you require further information, please contact Stuart Goodbody, Mark Politz or Simon Brown on 01892 510000 or by email at:

stuart.goodbody@ts-p.co.uk

mark.politz@ts-p.co.uk

simon.brown@ts-p.co.uk

* All references to the term 'spouse' include a civil partner as defined by Section 1 of the Civil Partnership Act 2004.

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