

CLIENT MEMORANDUM

CAPITAL GAINS FOR INDIVIDUALS

Capital Gains Tax for individuals was introduced in the UK in 1962. It was originally a limited tax on short-term gains. However, it was widened considerably in 1965 to cover virtually all gains of a capital nature.

From the outset, there have always been a number of reliefs and exemptions to alleviate the burden in certain circumstances. These rules have changed over the years, and are now quite complex.

The 2008 Budget made major changes to the rules. The current proposal to increase Income Tax rates next year means that it is more important than ever to fall within the capital gains rules rather than the income rules.

The purpose of this Memorandum is to summarise the main current rules for calculating gains, and also to describe the principal reliefs and exemptions. It also sets out some of the planning opportunities which are still available, as well as some of the pitfalls to watch out for.

LIABILITY

The tax applies to capital gains which accrue to a person in a year of assessment, during any part of which he or she is resident in the UK, or during which he or she is ordinarily resident in the UK.

There are special rules for people who are domiciled abroad, or who are temporary visitors to the UK, or who are temporarily non-resident. If any of this applies to you, we shall be happy to advise on your particular circumstances.

The tax rate for the current tax year is 18% (please see below for the special position which applies to the new entrepreneurs' relief).

Every individual is entitled to an annual exemption: this is currently £10,100, and is deducted from taxable gains before applying the tax rate. Thus if your gains (less losses) for 2009/10 do not exceed £10,100, there will be no liability. If, say, your gains (less losses) amount to £13,400, then £3,300 will be taxable at 18%.

A capital loss can be offset against capital gains of the same tax year, but cannot be carried back against gains of earlier years.

If you have an unused capital loss, this can be carried forward indefinitely against gains of future years.

We show below the inter-action between capital loss relief and the annual exemption.

Example 1

2009/10	
Gains	14,000
Less losses of same year	12,000
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	2,000
Less annual exemption (restricted)	2,000
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Taxable	-
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Losses c/f: Nil	

Example 2

2009/10	
Gains	12,500
Less losses b/f £12,000 (restricted)	2,400
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	10,100
Less annual exemption	10,100
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Taxable	-
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Losses c/f: £9,600	

In other words, the usage of losses brought forward is restricted, so that the usage of the annual exemption is maximised.

It is important to note that capital losses cannot be offset against income, they can go only against capital gains (subject to certain very limited exceptions which are mentioned below).

Capital gains and losses are (broadly) calculated as the difference between the proceeds of the relevant asset and its cost. It is usually possible to take account of legal and similar fees, as well as capital expenditure incurred on the asset during the period of ownership.

The tax applies to nearly all capital assets, including shares, properties and antiques. Certain items, such as cars, are not covered, except in special circumstances.

If tax is payable, the liability falls due on January 31 following the end of the year of assessment. Thus Capital Gains Tax on gains made during the year ended 5 April 2009 is payable on 31 January 2010.

HUSBANDS AND WIVES

Spouses are treated separately, and each is entitled to an annual exemption. The same applies to civil partners.

For Capital Gains Tax purposes a husband can transfer an asset to his wife without incurring tax, and vice versa. The transferee, in effect, steps into the shoes of the transferor and will be liable to tax on a future sale as if he/she had always owned the asset.

The same applies with civil partners.

Special rules operate where there is a divorce or separation, or the dissolution of a civil partnership.

TAX PLANNING

There are many ways in which it may be possible to mitigate potential Capital Gains Tax liabilities.

Care is needed in this connection, as there are a number of anti-avoidance provisions which must be taken into account and we shall be happy to advise in your particular circumstances.

We give below some examples of possible tax-saving strategies:

- (i) Bed and breakfasting. If you have a large realised gain, you may consider realising a loss of a similar amount by selling an asset in the same tax year to realise an equivalent loss for offset. This works particularly well with quoted shares and, if you do not want to dispose of them long-term, you may wish to sell them and then buy them back after 30 days have expired (to overcome an anti-avoidance rule). This is called “bed and breakfasting”.
- (ii) Let us suppose that you have some shares showing a large accrued gain and your wife has some shares selling a large accrued loss, and you both want to sell. It might be sensible for you to transfer your shares to your wife so that she can sell them in the same tax year as her loss-making shares so that the loss and gain both arise in her hands and can be offset. The reverse procedure would also work of course i.e. your wife transfers her shares to you so that you can sell them in the same tax year as your own shareholding.

EXEMPTIONS

There are some important exemptions from the Capital Gains Tax charge. The principal ones are briefly described below:

- (i) Principal private residence. The gain on sale of a person’s main residence is normally exempt. The relief also covers the last 36 months of ownership even

if the owner was living elsewhere during that period. There is only one private residence exemption for a husband and wife living together or for both members of a civil partnership.

There may be problems if you own two or more homes. We shall be happy to advise you in this connection. In certain circumstances it may be possible to obtain an element of tax exemption on your second home by the judicious use of elections as to which property is your main residence.

It should be noted that, if you use part of your main residence exclusively for business or letting purposes, that element will not qualify for the main residence exemption (but see below about the possible use of rollover relief in this situation).

- (ii) Let property. If your home was let for part of the period of ownership, then the gain on disposal will be apportioned. The element which is attributable to the letting can qualify for a relief of up to £40,000, depending on the circumstances.
- (iii) Converting a capital loss to a trading loss. In certain situations, it may be possible to transform a capital loss into a trading loss: this will usually be a helpful course of action if you are paying Income Tax at or above the basic rate, and will be particularly valuable next year when the top rate of Income Tax increases to 50%, compared with the current top rate of 18% for capital gains! In order to obtain this relief, it is necessary that you should have subscribed for shares in an unlisted trading company. There are a number of other conditions which must be met, so please let us know if you think that you may be eligible for this valuable relief!
- (iv) Negligible value claims. These can apply if you hold a capital asset which recently became worthless or very nearly worthless. This sometimes happens with properties, eg investments in overseas time-shares. More commonly, it can apply to shareholdings in quoted or unquoted companies. For instance, HMRC have recently accepted that shareholdings in Northern Rock Plc and Bradford and Bingley Plc have "become of negligible value". Anyone holding these shares can, if they wish, generate a capital loss (for offset against capital gains) by asking HMRC to treat the holding as having been sold at market value and re-acquired at the same date. Please contact us for more information if this could apply to you.

RELIEFS

If there is a capital gains liability having taken account of everything set out above, then it may be possible to eliminate or defer the tax liability by taking advantage of certain reliefs which are available.

We describe these briefly below, and would be happy to explain them in more detail, if desired.

(i) **Enterprise investment scheme (“EIS”)**

By subscribing for the new shares of a qualifying unquoted trading company you can “shelter” your gains. You must invest the gain arising on the original disposal within one year before the original disposal or three years afterwards. There is no monetary limit on this relief, but the tax liability is deferred, not eliminated. It will crystallize on disposal of the EIS investment.

(ii) **Rollover relief**

This applies where you sell a business asset and a capital gain arises. In very broad terms, you can claim rollover relief if you invest the proceeds in a further business asset and you buy it within one year before or three years after the disposal. Subject to certain conditions, you can “rollover” the gain so that the tax is not payable until you sell the new asset.

This can be particularly helpful if you have been using an office building for your business and you sell the building and acquire alternative premises. The relief also covers the situation where you move house and both your old and new houses are (or were) used partly for business purposes.

Special rules apply if one or both of the properties is leasehold and the lease runs for less than 60 years.

There is another important relief which was introduced with effect from 6 April 2008. This is called the “entrepreneurs’ relief”. If this relief applies, the gain (up to a lifetime entitlement of £1 million) is reduced by $\frac{4}{9}$ ths, which means that the effective rate of Capital Gains Tax on the gain becomes 10% ($\frac{5}{9} \times 18\%$).

The rules are complex, but the relief applies in two principal situations:

- (i) Sale of shares in the taxpayer’s personal trading company, provided that the individual is an employee of the company and holds at least 5% of the share capital.
- (ii) Sale of business assets (e.g. goodwill or trading premises) where the individual owns the business or is a partner in it, and the sale occurs in connection with the disposal of part or all of the business.

It should be noted that the company does not necessarily have to be trading at the time of the disposal, so the low 10% effective rate may be available where the disposal occurs as a result of the winding-up or striking-off of a company.

It should be borne in mind that an individual can buy quoted shares via an ISA (“individual savings account”) within a current annual limit of £7,200. Any sales of these shares by the ISA are exempt from Capital Gains Tax. The maximum annual investment limit goes up to £10,200 from 6 October 2009 for people aged 50 or over. That new limit applies to everyone from 6 April 2010.

Finally, it should be mentioned that there is no Capital Gains Tax liability on death! A taxpayer's assets are regarded as being acquired by the personal representatives at market value at the time of death; however there is no corresponding tax liability for the deceased.

SUMMARY

It is clear from the above that Capital Gains Tax has many ramifications for individual taxpayers and steps can frequently be taken in advance to reduce potential liabilities, especially having regard to capital losses flowing through due to the recent sharp falls in share prices in some sectors of the economy.

FOR GENERAL INFORMATION ONLY

Please note that this Memorandum is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.