E:info@cleverdon.biz
W:www.cleverdon.biz

12 October 2007

Capital Gains Tax Reforms - How will they affect you?

The Government announced in the Pre Budget report (PBR) that it intends to abolish some tax reliefs and replace them with a flat rate of 18% for gains exceeding the annual allowance. The proposals will be sent out for consultation by HM Revenue and Customs, but as they currently exist they could influence your plans to sell before or after April 2008.

Although these proposals may impact on you if you are selling property, shares or other assets, you will also need to consider them if you are intending to hold onto your property, shares in your company or other assets. There may also be action you could take before April 2008 to make use of the current relief available.

We advise you to contact Tom Moffatt to discuss these matters in more detail but for your information we have highlighted a few common examples below. Examples two to seven show how changes in circumstance would result in different decisions based on the tax consequences.

Example 1: 40% tax payer selling a business asset

A sole director/shareholder set up the company in August 1982. The shares were issued at a cost of 20,000. The shares will be sold in April 2008 for 250,000. Indexation is 20,940 (cost multiplied by 1.047). Taper relief 156,795. This is a 40% tax payer who makes no other disposals.

If it is sold before April 2008, the gain will be (250,000 less indexation 20,940 less taper relief 156,795 less cost 20,000 less annual exemption 9,200 =) 43,065 chargeable at 40% = 17,226.

If sold after then, the gain will be (250,000 less cost 20,000 less annual exemption 9,200 =) 220,800 chargeable at 18% = 39,744.

A delay in sale would result in a higher tax charge of 22,518.

Example 2: 40% tax payer selling a non-business asset (1982 market value)

A property was bought in 1978 for 34,000. Its market value in 1982 was 25,000. Indexation is 35,598 (higher of 34,000 and 25,000 multiplied by 1.047). Taper relief 112,160. Sale proceeds will be 350,000. This is a 40% tax payer who makes no other disposals. The option to use cost of an asset owned before March 1982 has been abolished from 6 April 2008.

If it is sold before April 2008, the gain will be (350,000 less indexation 35,598 less taper relief 112,160 less cost 34,000 less annual exemption 9,200 =) 159,042, chargeable at 40% = 63,617.

If sold after then, the gain will be (350,000 less market value March 1982 25,000 less annual exemption 9,200 =) 315,800 chargeable at 18% = 56,844.

A delay in sale would result in a lower tax charge of 6,773.

Example 3: 40% tax payer selling a non-business asset (1982 market value)

A property was bought in 1978 for 34,000. Its market value in 1982 was 70,000. Indexation is 73,290.(Higher of 34,000 and 70,000 multiplied by 1.047). Taper relief 82,684. Sale proceeds will be 350,000. This is a 40% tax payer who makes no other disposals. The option to use cost of an asset owned before March 1982 has been abolished from 6 April 2008.

If it is sold before April 2008, the gain will be (350,000 less indexation 73,290 less taper relief 82,684 less market value 70,000 less annual exemption 9,200 =) 114,826, chargeable at 40% = 45,930.

If sold after then, the gain will be (350,000 less market value March 1982 70,000 less annual exemption 9,200=) 270,800 chargeable at 18% = 48,744.

A delay in sale would result in a higher tax charge of 2,814.

Example 4: 40% tax payer selling a non-business asset

A holiday home used solely by the owner and his family was bought in June 1996 for 80,000 to be sold in April 2008 for 265,000. Indexation is 5,040 (cost multiplied by 0.063). Taper relief 71,984. This is a 40% tax payer who makes no other disposals.

If it is sold before April 2008, the gain will be (265,000 less indexation 5,040 less taper relief 71,984 less cost 80,000 less annual exemption 9,200=) 98,776 chargeable at 40% = 39,510.

If sold after then, the gain will be (265,000 less cost 80,000 less annual exemption 9,200=) 175,800 chargeable at 18% = 31,644.

A delay in sale would result in a lower tax charge of 7,866.

Example 5: 40% tax payer selling a non-business asset

A property was bought in November 1985 for 140,000 to be sold in April 2008 for 400,000. Indexation is 97,300. (Cost 140,000 multiplied by 0.695). Taper relief 65,080. This is a 40% tax payer who makes no other disposals.

If it is sold before April 2008, the gain will be (400,000 less indexation 97,300 less taper relief 65,080 less cost 140,000 less annual exemption 9,200 =) 88,420, chargeable at 40% = 35,368.

If sold after then, the gain will be (400,000 less cost 140,000 less annual exemption 9,200 =) 250,800 chargeable at 18% = 45,144.

A delay in sale would result in a higher tax charge of 9,776.

Example 6: 22% tax payer selling a non-business asset

A property was bought in September 2004 for 55,000 to be sold in April 2008 for 80,000. No indexation. Taper relief 1,250. This is a 22% tax payer who makes no other disposals.

If it is sold before April 2008, the gain will be (80,000 less indexation nil less taper relief 1,250 less cost 55,000 less annual exemption 9,200) = 14,550, chargeable at 22% = 3,201.

If sold after then, the gain will be (80,000 less cost 55,000 less annual exemption 9,200) = 15,800 chargeable at 18% =) 2,844.

A delay in sale would result in a lower tax charge of 357.

Example 7: 22% tax payer selling a non-business asset

A property was bought in March 1982 for 15,000 to be sold in April 2008 for 80,000. Indexation is 15,705. Taper relief 19,718. This is a 22% tax payer who makes no other disposals.

If it is sold before April 2008, the gain will be (80,000 less indexation 15,705 less taper relief 19,718 less cost 15,000 less annual exemption 9,200 =) 20,377, chargeable at 22% = 4,483.

If sold after then, the gain will be (80,000 less cost 15,000 less annual exemption 9,200 =) 55,800 chargeable at 18% = 10,044.

A delay in sale would result in a higher tax charge of 5,561.

Broadly, if the proposals are implemented as they currently stand, it will mean that, after 5 April 2008, individuals who sell non-business assets will be subject to less tax, while those selling business assets are likely to be liable for significantly higher Capital Gains Tax bills. There are however exceptions to this generalisation due mainly to the abolition of indexation allowance and taper relief for assets sold after 5 April 2008.

The regime for charging companies corporation tax on their chargeable gains has not been changed so they will still be entitled to indexation allowance but not taper relief.

The following information may be appropriate for some individuals:

1. Those running a trading company who are currently questioning if they should continue trading as a limited company and who are entitled to business asset taper relief on the sale of the company may consider dis-incorporation to take advantage of indexation up to March 1998 and taper relief (75% if asset owned for two years) then continuing to run the business as a sole trader or partnership.
2. Individuals who have held assets like properties for some time and who are considering if they should trade through a company in the future may wish to consider accelerating that decision.
3. For individuals considering selling an asset which is subject to capital gains tax in the near future, the capital gains tax should be calculated under both the old and new systems so that the individual can decide whether to sell before or after 5 April 2008.
4. AIM (Alternative Investment Market) shares qualify for 75% business asset taper relief if held for at least 2 years. Shareholders may wish to review these holdings before 6 April 2008 to take advantage of the current relief.

Please note in each of the examples the following assumptions have been made:

The annual exemption is not yet known and will be announced in the 2008 Budget, so for illustration the 2007/08 figure has been used. It has been assumed that there are no other gains in 2007/08 or 2008/09 for the purposes of illustration, tax rates and allowances have not been altered prior to April 2008, gains are treated as a top layer of income, but this will no longer be the case from 6 April 2008.

Reliefs not affected are principal private residence relief, business asset rollover, Enterprise Investment Scheme and Venture Capital Trusts, business asset gift hold over relief, losses brought forward.