

Capital gains tax

A brief history

CGT was first introduced in 1965. Until then capital gains were not subject to tax. This had led many people to avoid income tax by converting (taxable) income into (tax free) capital gains. A capital gain is the profit you make when you sell an asset for more than you paid for it and the law sometimes taxes you on capital gains that you are deemed to have made when you give certain assets away or otherwise dispose of them without selling them.

At various times in the past the capital gains tax system has provided major reliefs which have also complicated the system. Taper relief, indexation or inflation linked reliefs are no longer available, although gains attributable to periods of ownership prior to 31 March 1982 are exempt from CGT.

What is CGT?

CGT is a tax on the profit you make from selling certain assets such as property, shares or other investments e.g. antiques and fine art.

A charge to CGT usually arises after you sell an asset but can also occur when you:

- give away a chargeable asset;
- transfer a chargeable asset to another person;
- exchange a chargeable asset for something else; or
- receive compensation for the loss or destruction of an asset, e.g. an insurance payout.

At its simplest, a capital gain is calculated by deducting from the sale proceeds of an asset:

- what you originally paid for it (or its market value at the date you inherited it or when it was given to you);
- any costs you incurred when you bought it (e.g.: solicitors fees for buying a property);
- any costs you incurred enhancing or improving it; and
- any costs you incurred when selling it (e.g.: commission to a sales agent or auction house).

CGT rates

Everyone is allowed to make a certain amount of tax free capital gains each year. This 'annual exempt amount' is currently £12,000 for individuals and £6,000 for trusts.

CGT is charged at a simple flat rate of 20% (2018-19: 20%) and this applies to most chargeable gains made by individuals. If taxpayers only pay basic rate tax and make a small capital gain they may only be subject to a reduced rate of 10% (2018-19: 10%). Once the total of taxable income and gains exceed the higher rate threshold, the excess will be subject to 20% CGT.

An 8% surcharge applies to the sale of chargeable residential property (apart from a principal private residence) and carried interest (the share of profits or gains that is paid to asset managers).

A lower rate of 10% applies to capital gains that qualify for entrepreneurs' relief (ER) or investors' relief (IR). Limited companies do not pay CGT. Instead they pay corporation tax on their chargeable gains which qualify for fewer reliefs and exemptions than those available to individual taxpayers.

Payment of tax

CGT is due for payment on 31 January following the end of the tax year. For example, for the tax year ending 5 April 2019, any CGT due must be paid by 31 January 2020 in order to avoid penalties and interest.

Notifying HMRC of liability to CGT

If you are required to complete a self assessment tax return, you are required to notify HMRC of any taxable gains on the capital gains pages of the return. As with income tax you are required to calculate your liability to CGT even though this requires an understanding of the rules, the exemptions and the available reliefs.

If you do not automatically receive a tax return each year you must still notify HMRC that you have a CGT liability. Tax geared penalties and interest are charged when CGT is paid late.

The law requires you to notify HMRC by 5 October following the end of the relevant tax year. HMRC will then issue a tax return and this must be completed within 3 months and any tax paid by the same deadline.

You are only required to report capital gains as and when you have a liability to pay CGT. In most cases therefore no return is required where total gains in a tax year are less than the annual tax-free allowance. Of course, someone needs to prepare the calculations to establish whether there is a liability to CGT.

Losses

Sometimes you may sell an asset for less than paid for it. In such circumstances you would make a capital loss. You can typically deduct capital losses from capital gains made in the same or future years. As a general rule, if the asset would have been liable to CGT had a gain taken place then the loss should be an allowable deduction.

If you own shares or other assets that become worthless you can make a 'negligible value claim'. This procedure allows you to establish a capital loss even though you are still the legal owner of the 'asset'. Such losses can be deducted from other capital gains as noted above.

Main home exemption from CGT

Most people are aware that they do not have to pay CGT when they sell their principle private residence. The exemption does contain some restrictions however, if, for example:

- the house was not used only as a main residence throughout the period of ownership;
- the garden or grounds, including the site of the house are greater than 5,000 square metres;
- part of the home was ever used exclusively for business purposes;
- all or part of the home has been rented out;
- the main reason the home was purchased was to make a profit from a quick sale;
- the owners have moved to another home before selling the old one;
- the occupiers are married or are in a civil partnership and own more than one main residence at a time.

In many of these situations it will be necessary to apportion the capital gain to identify how much qualifies for the main residence exemption. And further exemptions may be available to relieve any part of the gain that is not automatically exempt.

For example, in most cases the final eighteen months of ownership will be treated as if occupied by the home owner even if they have moved to live elsewhere. There are also special rules where the owner was not living in the house due to a requirement to live elsewhere for work related reasons.

Contrary to a popular myth, if you work from home you will not automatically affect your entitlement to the main residence exemption. The important issue is to ensure that you do not identify any specific room or area in the house as being used exclusively for business reasons. Occasionally this is unavoidable where your business requires the conversion of a room into something like a surgery, clinic or studio that is used exclusively for business purposes. In such cases, when the house is sold, it will be necessary to compute how much of any capital gain relates to the room or area used exclusively for business purposes.

When an individual, married couple or those in a civil partnership own more than one home, they can make a formal election as to which one should (in due course) benefit from the main residence exemption. You need to make this election within two years of having more than one home. You are also allowed to change your mind, or vary the election, within two years of acquiring another home.

Main home lettings relief from CGT

Home owners who let out all or part of their house may not benefit from the full main residence relief but can benefit from lettings relief. The maximum amount of this relief will be the lower of:

- £40,000;
- the amount of main residence relief due;
- the amount of gain you've made on the let part of the property

From April 2020, the government intends to make two changes to the relief from CGT rules for the sale of a principle private residence:

1. The final exempt period will be reduced from 18 months to 9 months, with no change to the 36 months available for those disabled or in care homes, and
2. Lettings relief will be reformed so that it only applies in certain circumstances where the property owner is in shared occupancy with the tenant.

CGT on sale of residential property

There is a new requirement to make a payment on account, within 30 days of a sale, of any CGT due on the disposal of a residential property. The changes apply from April 2019 for non-UK residents and will apply from April 2020 for UK residents. This will not apply where no CGT is payable, for example if covered by private residence relief.

Non-UK residents and capital gains tax

There is a CGT charge on the sale of UK residential property by non-UK residents. Only the amount of the overall gain relating to the period after 5 April 2015 is chargeable to tax. Private residence relief where a property is the owner's only or main residence will apply under certain circumstances.

The amount can be calculated by either:

- establishing the value of the property as of 5 April 2015 (known as 'rebasings') and then calculating the amount of gain over that value in the normal way;
- apportioning the whole gain on the basis of the time you held the property after 5 April compared to the total time the property has been owned.

Anyone that is not resident in the UK and sells a UK residential property will be required to notify HMRC and pay any CGT due within 30 days after the property sale is completed (i.e. the date when title is conveyed). The reporting and payment can be completed electronically.

A non-UK resident taxpayer that is already within the UK's self assessment system for Income Tax and CGT will also have the option of paying any CGT due as part of their normal year-end tax payment.

Other exemptions from CGT

Apart from the family home, there are other exemptions from CGT and special rules that apply to gains made in relation to certain other assets, such as:

- Assets sold for less than £6,000 (e.g.: antiques and paintings);
- Wasting assets (e.g.: cars and wine);
- Stocks and shares held in an ISA account;

- National savings certificates and premium bonds;
- Winnings from betting, lottery or the pools;
- Compensation for personal injury;
- Qualifying enterprise investment schemes.

None of the above exemptions apply when the gains arise through trading or business activities as distinct from occasional sales and disposals.

Entrepreneurs' relief (ER)

When you sell a business, shares in a trading company or your interest in a trading partnership, you will often be able to claim Entrepreneurs' relief so that you only have to pay 10% CGT rather than the normal rate of 20%.

When the relief was first introduced there was a lifetime limit of £1m for gains. This was increased to £2m with effect from 6 April 2010, to £5m from 23 June 2010 and to £10m from 6 April 2011.

The relief is available to individuals who:

- are in business, for example as a sole trader or as a partner in a trading business
- or
- hold shares in a personal trading company.

There are a number of qualifying conditions that you must meet in order to qualify for the relief. The lifetime limit means that you can qualify for the relief more than once, subject only to the fact that 20% tax will be charged once your total qualifying capital gains exceed £10m.

Since 17 March 2016, a variant of ER, called investors' relief (IR), is available to investors in unlisted trading companies. This relief applies a 10% rate of CGT to gains accruing on the disposal of ordinary shares in an unlisted trading company up to an additional lifetime cap of £10 million. Shares must be held for a minimum period of three years to qualify.

Other reliefs from CGT re business assets

Business asset roll-over relief

This relief from CGT is available when you sell a business asset and buy a new asset to replace it. If you satisfy all the necessary conditions, you can 'roll-over' the capital gain into the new asset. This enables you to postpone your liability to CGT until the replacement asset is sold without itself being replaced by another qualifying replacement.

Incorporation relief

If you own a business as a sole trader or in partnership with others you may at some point want to convert this into a company. A capital gain will be deemed to arise when you do this by reference to the market value of your business assets including goodwill. A number of options exist in such situations.

One of these involves arranging the incorporation of the business so that it satisfies the conditions necessary to secure 'incorporation relief'. One such condition is that the entire business must be transferred as a going concern in exchange for shares in the new company.

Gift hold-over relief

Where a business asset is gifted or sold for less than its market value, CGT is still chargeable by reference to the market value of the asset. This commonly arises within families, for example, where a parent transfers a business or business premises to their children. In such cases the taxable gain can be postponed until the recipient of the gift sells the asset.

31 March 1982

Although CGT was introduced in 1965, the rules aim to avoid taxing any gain that arose before 31 March 1982.

If you make a capital gain on an asset you owned on 31 March 1982, special rules apply. You will be deemed to have acquired the asset on that date at its then market value. You should then use that value instead of the actual costs prior to that date when computing your taxable gain. The indexation allowance on corporate capital gains for disposals was frozen as of 31 December 2017.

Record keeping

HMRC do not specifically detail which records should be kept as the records depend on many circumstances. However, you should ensure you retain any records associated with all material assets you have owned, and you should always keep any information you might need to evidence:

- the figures required to calculate your capital gains and losses;
- the market value of assets you owned at 31 March 1982;
- entries on your self assessment tax return; and
- your entitlement to reliefs and exemptions.

Valuations

It will often be necessary to include valuations in the calculations of capital gains. For example, if the asset was originally inherited, has been given away or was received as a gift, or when it was acquired before 31 March 1982.

In such cases it is important to disclose on your tax return the name and qualifications of the valuer. Although not a legal requirement, this disclosure should protect you from a late discovery by HMRC. This in turn should remove the prospect that can later demand you pay more CGT plus interest and penalties long after the normal payment date.

How we can help

We would welcome the opportunity to help ensure that you claim all available allowances and reliefs when computing your liability to CGT. We can also undertake these calculations and ensure that you make all necessary disclosures to HMRC. Where necessary, we can also introduce you to appropriately qualified valuers.

We would also be pleased to determine if there might be ways to limit your potential liability to pay CGT. This is something best done long before you realise your capital gains so it is easier if we are familiar with your tax affairs. We could then discuss with you the steps that you could take to reduce your liability. We would aim to help ensure that you become liable to no more than the minimum CGT than is legally necessary.