

## **CHANGES TO CAPITAL GAINS TAX FROM APRIL 2008**

*October 2007*

### **ALL CHANGE FOR CGT**

The Pre Budget report delivered on 9 October 2007 brought in some major changes to Capital Gains Tax for individuals (including business partnerships) from 6 April 2008. As a result of this most business people / private investors would be advised to review their GCT position before then to see if there are any planning opportunities to consider.

The rules for taxing Capital Gains made by companies do not change, but directors / shareholders still need to consider how the new rules impact on them personally and potentially interact with corporate tax matters.

### **THE CURRENT RULES AND THE NEW RULES**

Currently CGT is worked out as follows:

Sale proceeds of asset	£x,xxx
Less base cost / purchase price (1982 valuation if bought before 1982)	£x,xxx
Less indexation on base cost to April 1998	£x,xxx
Subtotal	
Less taper relief April 1998 to date	£x,xxx
Taxable gain	£x,xxx
Less annual exemption	£x,xxx
Subject to tax	£x,xxx

Tax is then charged at 20% or 40% dependant on an individuals other income for the year – in fact the gain is treated as the top slice of income, using the same 40% threshold as for Income Tax.

Indexation is a relief for inflation applied to the base cost, between 1982 and 1998. Taper is a percentage reduction in the subtotal gain after indexation, applied post 1998 – for business assets taper is a very generous relief, exempting 75% of the gain after two years (NB this is where the oft talked about 10% CGT rate comes from – 40% tax rate less 75% = 10%).

Other CGT reliefs apply, eg hold over reliefs, rollover reliefs and reliefs for private home and similar.

From 6 April 2008 the following changes:

- taper and indexation are abolished
- a flat 18% tax rate is applied.

## LETS LOOK AT SOME FIGURES

### Example, directly owned asset £1m proceeds

Assume:

- Asset cost £200,000 in April 1990.
- Taxpayer has other income of £20,000 PA, leaving, under current rules £20,000 of basic rate band free for 20% CGT, balance of any gain under current rules taxed at 40%
- asset sold April 2008

	Old rules, business asset £	Old rules investment asset £	New rules £
Proceeds	1,000,000	1,000,000	1,000,000
Less cost	(200,000)	(200,000)	(200,000)
Less indexation on cost	(60,000)	(60,000)	-
Gain before taper	740,000	740,000	800,000
Business Asset Taper	(555,000)	-	-
Investment Asset Taper	-	(296,000)	-
Gain after taper	185,000	444,000	800,000
Annual exemption (2007/8 rates)	(9,200)	(9,200)	(9,200)
Taxable gain	175,800	434,800	790,800
Tax due			
20%/40%	66,320	169,920	-
18%	-	-	142,344
Effective rate	6.6%	17.0%	14.2%

It can be seen that the effective tax rate on a business asset was 6.6% and rises to 14.2% - for a investment asset it was 17.0% and falls to 14.2% - so on these figures the changes benefit non business investors but adversely hit business investors.

## LETS LOOK AT SOME FIGURES (continued)

### Example, directly owned asset £100,000 proceeds

Assume:

- Asset cost £20,000 in April 1990.
- Taxpayer has other income of £20,000 PA, leaving, under current rules £20,000 of basic rate band free for 20% CGT, balance of any gain under current rules taxed at 40%
- asset sold April 2008

	Old rules, business asset	Old rules investment asset	New rules
	£	£	£
Proceeds	100,000	100,000	100,000
Less cost	(20,000)	(20,000)	(20,000)
Less indexation on cost	(6,000)	(6,000)	-
Gain before taper	74,000	74,000	80,000
Business Asset Taper	(55,500)	-	-
Investment Asset Taper	-	(29,600)	-
Gain after taper	18,500	44,400	80,000
Annual exemption (2007/8 rates)	(9,200)	(9,200)	(9,200)
Taxable gain	9,300	35,200	70,800
Tax due			
20%/40%	1,860	10,080	-
18%	-	-	12,744
Effective rate	1.9%	10.1%	12.7%

In this example, in contrast to the one on the preceding page, both business and non business investors are worse off.

## **BUSINESS OR NON BUSINESS**

The examples above show, broadly, that business investors are always worse off, non business investors may be worse off, may be better off.

So what makes a business v non business investor. Well its to do with the assets being sold. Lets look at the list:

### **Business**

- A commercial property buy to let, even if you have nothing else to do with the business
- Shares in a private company
- A property used for your business
- Business assets such as goodwill, or plant and machinery

### **Non business**

- A residential property buy to let (buy to lets never count as a business)
- Shares in a listed company (other than AIM which counts as a private company)
- A second home
- Other investments, eg unit trusts, mutual funds, fine wine, art

This is obviously a simplified list, but it gives you an idea.

## **RETIREMENT RELIEF**

“I seem to recall there was a relief for retiring from a business?” – not any more! CGT Retirement Relief was abolished in 1998 when taper relief came in. Taper relief was made more generous for business assets in successive years, and up to now was a far better relief in most cases than the old retirement relief – now there is no relief on retirement at all.

When someone comes to retire, often the major asset to be sold is goodwill which will in many instances have no base cost to deduct, and hence no indexation – taper relief relieved such a gain generously. The new regime makes no such allowance.

## **INTERACTION WITH COMPANIES**

Suppose you own an asset via a company. You intend to sell the asset and you want to extract the proceeds – and suppose the choice is take the proceeds out as dividend, as the company is still trading, or wind the company up and take a capital gain. Again, lets look at the figures:

**Example, asset owned by company**

- Asset cost £20,000 in April 1990.
- Taxpayer has other income of £20,000 PA, leaving, under current rules £20,000 of basic rate band free for 20% CGT, balance of any gain under current rules taxed at 40%
- asset sold April 2008

	Corporation Tax £	Draw as dividend £	Capital gain (old rules) £	Capital gain (new rules) £
Proceeds	100,000			
Less cost	(20,000)			
Less indexation on cost	<u>(13,140)</u>			
(NB Indexation based on August 2007 figures, latest available)				
Gain subject to Corporation Tax	<u>66,860</u>			
Corporation Tax	<u>13,372</u>	<u>13,372</u>	<u>13,372</u>	<u>13,372</u>
Free funds after Corporation Tax	<u>86,628</u>	<u>86,628</u>	<u>86,628</u>	<u>86,628</u>
Income Tax on dividend		17,157		
Taper relief			(64,971)	
Annual exemption (2007/8 rates)			<u>(9,200)</u>	<u>(9,200)</u>
Taxable gain			<u>12,457</u>	<u>77,428</u>
Capital Gains Tax 20%/40%			2,491	
Capital Gains Tax 18%				<u>13,937</u>
Total Tax		<u>30,529</u>	<u>15,863</u>	<u>27,309</u>
Effective rate		30.5%	15.9%	27.3%

First thing to note is capital gain on winding a company up is still cheaper than dividend under both old and new rules, however the new rules push the tax cost up.

Also have a look at the example above of a directly owned (i.e. not via a company) asset sold with the same proceeds & cost. There the effective tax rates ranged between 1.9% and 10.1% on current rules, compared to 15.9% for a company owned asset, or 12.7% on the new rules compared to 27.3% on the new rules for a company owned asset. This backs up the long standing accountants rule of thumb that from a tax perspective assets are normally best owned personally rather than via a company.

NB as mentioned earlier, the new rules do not effect the calculation of a Capital Gain *within* a company which remain unchanged (cf the position for shareholders of a company, which does change). Companies have never qualified for Taper, and have indexation from 1982 right up to date.

## PLANNING

So, from a quick glance it can be seen that the new rules have a significant impact on CGT. Some people will win, many more will lose.

So planning opportunities to think about:

- If you are planning to sell a business asset it may be better to bring the sale forward so it takes place before April 2008 (nb date of exchange of contract is relevant, not completion / receipt of funds).
- If you are planning to sell a non business asset, then the figures need to be looked at carefully to see whether a pre or post April 2008 transaction is best.
- If you operate a small business via a limited company and may shortly be wanting to close the business down, eg retirement or returning to permanent work, then it may be worth while accelerating this closure to before April 2008 so that funds can be extracted from your business closure with the generous Business Asset Taper Relief. NB normally there is only merit in this if you are a Higher Rate taxpayer.
- If retirement is looming, or you are looking to pass assets on within the family, then it may be better to do so now rather than after next April.

NB these are all simple planning thoughts. Please seek full and tailored advice before acting or refraining to act on any matter.

## HOW WE CAN HELP

*For our existing clients* we can meet with you and review your CGT position and provide you with tailored advice that covers not only CGT in isolation but the interaction with other taxes and financial matters. Please note that such a review is not covered by our fixed fee arrangements and would be subject to separate charge at our normal hourly rates.

*For non clients* we can carry out a similar consultation on a fixed price basis for £195+vat – bookable by contacting us on 01983 400350 or [office@garbetts.com](mailto:office@garbetts.com)

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