Stay Ahead on Capital Gains Tax

A Quick Planning Guide

Big changes to capital gains tax on 6 April 2008 will benefit some people, but leave others worse off. What is certain is that nobody who owns a business or investments will be unaffected. You still have some time to check what impact the changes will have on you and plan for them. But don't leave it to the last moment as some arrangements take time to set up. Remember too that 6 April is a Sunday, so in practice you might only have until Friday 4 April to finalise matters.

What will change?

The main proposals are:

- Capital gains tax (CGT) will be charged at a uniform 18% instead of at 10%, 20% and 40%, depending on the amount of your income and gains in the tax year.
- Indexation relief, which adjusted for inflation between 1982 and 1998, will disappear.
- Taper relief will end. Taper relief reduces tax according to how long a person has owned an asset and is especially favourable for business assets.
- A new entrepreneurs' relief will reduce the effective CGT rate to 10% on gains of up to £1 million on sales of businesses and some associated sales.
- The rules for non-domiciled UK residents are being tightened up.

What can you do?

There is plenty you can do to make sure you are among the winners from the changes.

Timing a sale

Many investors will pay less tax if they wait until after 5 April to sell an asset such as property or quoted shares. At present, with non-business taper relief, a higher rate taxpayer pays CGT at rates ranging from 24% to 40%, depending on how long you have owned the asset. Delaying a sale will mean your gain is taxed at 18%.

Remember that it is the contract date that determines in which tax year a sale falls for CGT, not the completion date, if different.

If your gain would be taxed at the basic rate, you are likely to pay tax at a lower rate this year than next year on a sale of a non-business asset you have owned for five or more years.

Timing may be less important for people selling a business or shares in most types of family company. The tax you would pay on a sale this year is 10% of your gain on assets you have owned at least two years, the same as after 6 April 2008 with entrepreneurs' relief.

But entrepreneurs' relief is much more limited in scope than business taper relief:

- You need to sell the whole or part of a business that you carried on as a sole trader or partner, not just assets of the business, unless the business has ended.
- For sales of shares to qualify, you have to be an employee or director and own at least 5% of the company.
- Gains in excess of £1 million will be taxed at the full 18%.
- There are other conditions, and the proposals could change before 6 April 2008, so if you are selling a business you should take professional advice.

If you are selling business assets that will not qualify for entrepreneurs' relief, or an existing relief such as rollover relief, you are likely to pay less tax if you sell before 6 April 2008.

Indexation

Indexation complicates the decision on timing. Indexation particularly benefits landowners and anyone else who has owned assets with a high base cost for a long time. In effect, it more than doubles the cost of assets acquired in April 1982 or earlier and uplifts the cost of any asset bought up to March 1998.

If you do not want to sell an asset before 6 April 2008, you may be able to preserve the indexation allowance by transferring it to your spouse or civil partner before 6 April 2008.

- The transfer does not result in any tax, but your spouse or partner acquires it at a 'cost' that includes the indexation allowance. This acquired indexation will not be lost.
- The transfer must be genuine with no strings attached and preferably documented.
- HMRC has expressed approval of this strategy.

Employee shares

Shares acquired through an employer's scheme are unlikely to qualify for entrepreneurs' relief as an employee will rarely own 5% of the company. You might want to sell such shares before 6 April if you have owned them for two years or more (or for at least one year if you are a basic rate taxpayer) as you are likely to pay a higher rate of CGT under the new rules.

If you have enterprise management incentive (EMI) share options, business taper relief runs from the date you were granted the option, rather than the date you exercise it. You can benefit from taper relief by exercising your options and selling your shares before 6 April 2008.

Loan notes

Perhaps you have already sold a business and received loan notes or shares in the purchasing company. You need to decide whether to redeem the loan notes or sell the shares before 6 April 2008 to benefit from a lower CGT rate.

Taking loan notes or shares as consideration for selling a business defers CGT until the loan notes are encashed or the shares sold. If that happens after 5 April 2008, you will pay tax on the full gain without taper relief. Loan notes and most shares received in these circumstances will not meet the conditions for entrepreneurs' relief.

If you redeem your loan notes or sell your shares before 6 April, your deferred gain will qualify for taper relief. But you must take professional advice as loan notes and share exchanges vary in their tax consequences, and there are some anti-avoidance rules.

If you are currently selling a business and receiving some of the consideration as loan notes, you might benefit from electing not to defer your CGT. Again you need to take advice on the consequences.

Sale or gift to a trust

If you do not want to sell business assets now, you could still benefit from taper relief by transferring them to a trust for your own benefit. This is taxed as a sale at market value, so if you make the transfer before 6 April you would get taper relief. The drawback is that you have to pay the tax on 31 January 2009, so it is usually only worth doing if you expect to sell the assets fairly soon after 6 April.

If a trust pays anything for the asset, there may be stamp duty.

Non-domiciliaries

If you are not domiciled in the UK, you are taxed only on gains you remit to, or bring into, the UK. You may benefit from remitting gains to the UK in the current tax year or from delaying remittances. The remittance basis rules are complex and changing on 6 April. The decision will depend on your own circumstances and you should take advice.

Until now, non-domiciliaries have been able to avoid CGT by owning UK assets in an offshore trust or company. From 6 April 2008, you will be charged tax on sales by your offshore trust or company, so selling before that date might be advisable. Trust gains made before 6 April 2008 will not be taxed.

Other considerations

Tax should not be the only factor in your decisions. You must always consider the commercial consequences as well. For example, bringing forward a sale may be pointless if it means you have to accept a much lower price.

Remember also that the proposed changes are just that – proposals. The details might change. Even the Budget on 12 March might not be the final word.