

Briefing document

February 2008

Capital gains tax reform

Introduction

The Chancellor made a number of sweeping changes to the Capital Gains Tax (CGT) regime which will come into effect for disposals made on or after 6 April 2008 or deferred gains coming into charge after this date. The proposals are that a flat rate of CGT of 18% will apply to all gains arising after 5 April 2008 and both indexation allowance and taper relief will be withdrawn for all assets including those already held.

The withdrawal of indexation allowance and taper relief applies to both business assets and non-business assets. In addition there are changes to the rules applying to assets held at 31 March 1982 and to the share identification rules, although the 'bed and breakfasting rules' remain unchanged.

The CGT annual exemption will remain as will Principal Private Residence relief, Business Asset Rollover relief, Business Asset Gift relief and CGT reliefs available under the Enterprise Investment Scheme. Unused capital losses will continue to be available to carry forward and set against future gains.

The delayed announcement of these measures gives taxpayers only a very short time to arrange their affairs to mitigate any adverse effects of the changes. The purpose of this note is to provide you with an outline of the changes and their effect to assist with the decision of whether there is any action you should take prior to 5 April 2008. You should note that the comments below are from a tax perspective only and independent investment advice relevant to your own circumstances will need to be taken into account.

Indexation Allowance

Indexation allowance will no longer be available for disposals on or after 6 April 2008 when computing the capital gain arising.

Indexation allowance was introduced to take account of inflation over the period from the date allowable expenditure was incurred to the date of disposal.

For individuals and trustees, indexation allowance is available on capital gains crystallised between 5 April 1982 and 5 April 1998. From 5 April 1998 the indexation allowance attributed to an asset is frozen, and taper relief was introduced. Accordingly, indexation allowance is only available on assets acquired before 5 April 1998.

The rate of indexation allowance applicable is based on the increase in retail price index (RPI) between the date of incurring the expenditure and April 1998. For individuals and trustees, the maximum rate of allowance is 104.7% (for assets held from March 1982, or earlier, up to April 1998), which effectively more than doubles the allowable base cost in arriving at the chargeable gain.

Taper Relief

The withdrawal of taper relief will result in some dramatic increases and reductions in the effective tax rate for different assets after 5 April 2008.

At present, gains on business assets (very broadly shares in unquoted trading companies, properties let to certain business tenants, assets used in a business, quoted shares held by employees, loan stock received in exchange for qualifying assets) benefit from a 10% tax rate after two years ownership. Non business assets achieve a minimum rate of 24% after ten years ownership.

No immediate action will be required in relation to business assets that will have been owned for less than 2 years on 5 April 2008 as the effective tax rate will fall from either 40% or 20% to 18%. However owners of business assets held for more than 2 years could be faced with an increase in their effective rate of CGT from 10% to 18% unless the gains qualify for the new Entrepreneurs' relief.

For non-business assets the position will vary according to the period of ownership and the availability of indexation allowance. Assets held since March 1998 qualify for full taper which means that 40% of the gain is exempt giving an effective rate of 24% if the gains are taxed at higher rates and 10% if taxed at the basic rate. In most cases it will be necessary to calculate the impact particularly where the asset has been held for some time prior to April 1998 and will lose accrued indexation relief.

Kink Test

Where an asset was acquired before 31 March 1982 under current rules the cost can be either the actual cost or the market value on 31 March 1982 if this produces a lower gain. From 6 April 2008 the 31 March 1982 market value will be used in all cases.

Halving Relief

Where an earlier gain was rolled over into an asset that was acquired between 1 April 1982 and 6 April 1988 taxpayers can currently claim a reduction of half of the rolled over gain. This relief was introduced to compensate those taxpayers whose deferred gains under the hold over and/or rollover provisions were calculated before the option to rebase to 31 March values was introduced.

At the time that halving relief was introduced, holdover relief was available on gifts of any chargeable assets to individuals and trusts. This general form of a gift relief was abolished on 14 March 1989. A large number of trusts particularly Accumulation and Maintenance trusts were established around this time and a large number of deferred gains will currently benefit from this relief. To avoid the loss of this relief action needs to be taken prior to 5 April 2008.

Share Identification Rules

The matching of shares that have been sold will be much easier under the new rules. From 6 April 2008, subject to the continuation of the existing rules for shares acquired on the same day and within the next 30 days, all shares of the same class in the same company will be treated as a single asset, forming only one pool.

Individuals with existing share pools might be adversely affected by the new rules depending on the acquisitions date and costs of the shares in particular if the acquisition cost of more recently acquired shares is significantly higher than the average pooled cost of the holding.

Entrepreneurs' Relief

A new tax rate of 10% is proposed from 6 April 2008 for disposals of trading businesses and of shares in trading companies/groups by employees/directors holding 5% or more of the voting ordinary shares after 1 year. The new 10% tax rate is applied to the first £1 million of cumulative lifetime capital gains, with the excess subject to tax at 18%. We await the draft legislation on this subject to provide further detail of the relief.

Find out more...

To find out more about any aspect of the above, please discuss with your Deloitte contact who will be happy to help and can provide you with access to Deloitte's network of tax specialists.

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