CAPITAL GAINS TAX REVIEW … ‘HELP’
The potential for a change to the way in which capitals gains are taxed could be likely, and sooner rather than later writes Mattioli Woods’ Consultant, Paul Cliffe.

In 1965 The Beatles released their album Help, and in the same year James Callaghan introduced capital gains tax (CGT). Now more than ever, when UK PLC’s balance sheet needs a little help from its friends (different album), the Chancellor has commissioned a review of the CGT position. We have recently seen the Office of Tax Simplification announce that the deadline for responses to the second part of the consultation has been extended to 9 November 2020, albeit a budget this year has now been ruled out. However, the potential for a change to the way in which capitals gains are taxed could be likely, and sooner rather than later.

Let’s get back to the basic principles of CGT. It’s levied on profits made from the disposal of assets. It’s paid by individuals and trusts, and the annual exemption of £12,300 (£6,150 for most trusts although divided between the number of trusts set up by the settlor) has been a very useful tool to generate income/gains effectively to create additional tax-effective returns that, in conjunction with other income tax strategies, have given us another avenue to plan.

CGT is based on the tax rate of the individual and the type of asset being sold; for instance, basic-rate taxpayers are typically subject to 10% on gains from most assets and 18% on residential property, noting that currently primary residences are exempt from CGT. For trusts and higher rate taxpayers it is applied at 20% for most assets and 28% on other residential property. Even at these rates, they pale into relative insignificance when compared to income tax.

If we look at what CGT raises for HMRC as a percentage of all receipts, it is forecast that for the 2019/20 tax year this would equate to around £9.1 billion*, which isn’t really delivering much of a blow into the £300 billion reported cost of COVID-19 … and ignoring the additional costs of the second wave.

Looking at why CGT provides relatively small levels of revenue for the government, one angle, put very simply, is that individuals can possibly derive a greater net return being subject to CGT rather than to income tax. Let’s use the example that an individual owns an empty second home that (at the time of sale) creates a £100,000 gain after all costs and deductions are factored in. This individual does not have any other income. Based on the ‘gain’ being subject to CGT, this could create a £20,806 for HMRC, but if it were to be subject to income tax, it could create a £27,500 tax receipt for HMRC.
‘It’s getting better all the time’ doesn’t really fit right now… it’s with the above in mind, and while we’d love for the government to ‘let it be’, the likelihood that income tax rates and CGT rates will ‘come together right now’ seems an easy win for the government.

As advisers, we work with accountants and tax advisers when speaking with our clients about gains they could realise, or already have, and many of our conversations focus on utilising tax-efficient investment opportunities, preferably from the outset. Some individuals may create a gain to fully utilise their annual exemption before reinvesting it to increase their base cost (providing the share matching rules do not apply), or by using their annual ISA subscription allowance to reinvest the proceeds, where assets held are currently CGT free. Some clients, on the other hand, may defer paying the tax, such as through investing a gain into Enterprise Investment Schemes (EISs).

CGT is effectively another tax that can subsequently reduce the underlying net return from an investment. Before any changes to the rules, who wants to wish they had completed their planning ‘yesterday’? And acting on today’s rules could be more favourable than tomorrow’s. If you are worried about a buyer of assets, do not forget the ability to use your pension fund.

Let’s not forget, capital gains for companies are subject to corporation tax. We are already hearing rumblings about increases … is now the time to review transferring your commercial premises into your pension scheme as a starter?

Planning now is fundamentally protecting against the way assets may be taxed in the future, which could also have an adverse effect on assets that are currently CGT friendly, such as VCTs, EISs, primary residential property and classic cars.

Legislation is always subject to change, perhaps more now than ever in recent memory. While we can only plan on today’s rules, we must be mindful of the affect any changes could have on investment planning. The Chancellor is reviewing CGT, and the importance of assessing how any changes impact a client is essential, noting that the ability to position, react and benefit from legislative changes (or indeed minimise the negative affects) is where financial planners, alongside accountants, can really step up to the plate.

While CGT was introduced in the year in which The Beatles launched their album Help, as with any planning, regardless of any unfavourable rule changes, sometimes you have to look at the opportunities and ‘take a sad song and make it better’.

The information contained in this document is correct as of the 2020/21 tax year.