AF1 Capital Gains Tax.2023/2024
Part 1: Basic principles

The milestones for this part are to understand:

- What does CGT tax.
- Which assets are subject to CGT and which are exempt.
- Which transfers are exempt.
- How to calculate a CGT liability
- When any CGT due must be paid to HMRC

Scope of CGT

A CGT liability will arise if:

- An asset is subject to CGT.
- The disposal value is greater its acquisition value

A “disposal” will occur if the asset is sold or gifted.

Jo gives her daughter £100,000 of shares that she bought for £20,000. Although she has not received any money, she has a made a gain of £80,000 giving her a CGT liability.

The disposal value is the asset’s market value. There are no issues if the asset is sold “at arms-length” to a third party. However, if Jo’s daughter paid her £20,000, that is below its market value, she would still have made a gain of £80,000.

Not all property is subject to CGT. The study text gives a complete list but for the moment the following should be noted:

- An individual’s main home (Principle Private Residence)
- Life Insurance Policies in the hands of the original owner. This includes Insurance Bonds.
- ISAs
- Gilts and Corporate Bonds (but not Unit Trusts or OEICS investing in these)
- Assets with an expected lifespan of less than 50 years. These are known as wasting assets.

In addition, some disposals are always exempt even if the asset is normally subject to CGT. These are:

- Transfers between spouses or civil partners.
- Transfers to a charity
- Transfers made on death through a will or intestacy

Sam has an extensive art collection. He sells this whilst he is alive and realises a gain of £500,000. This would be subject to CGT

If he doesn't sell but passes it to his children on death all the gain would be wiped out and there is no liability for CGT.

When his children sell the paintings, the acquisition price will be the probate value.

Calculating the tax liability

The basic calculation is:

- Calculate the total taxable gains in a tax year
- Deduct the Annual Exemption (£6,000) to give the chargeable gain
- Apply the correct rate.

Calculating the gain

The starting point is to calculate the difference between the disposal and acquisition value of the asset. You must always use market value even if it is sold for less than this.

Jane bought £25,100 of shares in Acme Widgets in June 2005. She sells them in September 2023 for £42,400. There is a gain of £17,300.

In practice, there are usually sale and purchase costs that need to be taken into account.

A collector buys a painting for £10,000 at auction. If the auctioneer charges the buyer a 5% fee the acquisition cost will be £10,500.

Some years later it is sold for £20,000 and the auctioneer charges a 10% commission, he only receives £18,000 so the gain is £7,500.

The key is to ask yourself what was the total amount paid by the individual when they acquired the asset and how much did they receive when it was sold.

A further possible deduction is the cost of **enhancing** an asset. For example, the owner of a painting may spend money on having it cleaned as this will increase its value. This can be deducted when calculating the gain. On the other hand, the cost of insuring the painting could not be deducted. The test HMRC will apply is whether the expenditure enhances the value.

Enhancement can be grey area particularly with residential property. The costs of renovating a property before it is let would be an expense against CGT. The cost of insuring the property and paying a managing agent would be an expense against income. Regular maintenance such as decorating the property every seven years falls into this grey area. It will probably be viewed as an income expense as it is something that must be done and doesn't enhance the value of the property.

There is also the possibility of **rebasing** which applies if the asset was purchased prior to 31st March 1982. Inflation was above 10% for a large part of the 70's and early 80's. This meant that "real" gains, i.e. over and above inflation were small and sometimes non-existent. To compensate for this the 1982 budget allowed investors to treat the acquisition value as the value March 31st 1982.

Ian purchased shares in a company in 1970 for £1 a share and these were worth £4 a share at March 31 1982, the purchase price for any future calculation would be £4 a share.

Part Disposals

Problems can arise where there is disposal of part of an asset. For example, someone may buy a set of figures and then decides to sell part of them. The disposal price will be known but at what price was this part acquired? When the remaining pieces are sold what will their acquisition price be?

The solution is to apply this formula

$$\frac{A}{A + B} \times \text{original cost}$$

Where A is the proceeds of the part disposed and B is the market value of the retained part

Sid buys an asset for £10,000 and sells part of it for £20,000, with the remainder being worth £60,000 The deemed cost of the part disposed of is £20,000/£20,000 + £60,000 x £10,000 = £2,500 The gain on the part disposal is £20,000 less £2,500 = £17,500 The deemed cost of future disposal of the remainder will be £7,500

Annual exemption

Having calculated all the gains these are totalled and the **annual exemption of £6,000** is deducted to establish the **chargeable gain**.

The annual exemption is on a "use it or lose" basis. It cannot be carried forward to the following tax year.

Applying the correct rate

The rate is determined by adding the total of chargeable gains made in the tax year to the individual's income.

For all assets other than residential property

- Any of the gain that is in the basic rate band is taxed at 10%
- Any of the gain in the higher rate band is taxed at 20%
- If the gain straddles the basic and higher rate band, then part is taxed at 10% and part at 20%

Gains on residential property carry an 8% surcharge so the rates are 18% and 28%.

> Having deducted the annual exemption Jane has a chargeable gain of £10,000. Her total income is £26,700 after deduction of her personal allowance so she still has £11,000 of her basic rate band left. The gain is all in the basic rate band so is taxed at 10% giving a tax charge of £1,000
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> If her income was £60,000 she would already be a higher rate tax payer so 20% would be charged giving a tax bill of £2,000.
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> If she had £5,000 of her basic rate band left, £5,000 would be taxed at 10% with £5,000 taxed at 20% giving a total bill of £1,500

Note that there is no special rate for additional rate tax-payers who also pay CGT at 20%.

Anyone who has some unused income tax PA cannot offset this against a gain. They will have to pay 10% of the first £37,700 over the CGT annual exemption

If the basic rate threshold has been increased by Personal Pension contributions or Gift Aid contributions, then the amended threshold will be used in calculating what rate of CGT is payable.

> Jenny has a total income of £50,570. This is the point at which the next £ of income would be taxed at 40% (£12,070 + £37,700) so if she makes a chargeable gain it will be taxed at 20%
>
> If she makes a PP contribution of £4,000, this will be grossed up to £5,000 and her basic rate band extended to £42,700. Now the first £5,000 of any chargeable gain will be charged at 10%

Paying CGT

Payment of any CGT is due on the 31st January following the end of the tax year the gain was made. There are no payments on account.

This can be done through **self assessment** or using the **Real Time CGT reporting service**. With the latter the gain must be reported to HMRC by 31 December following the end of the tax year in which the gain was made

However if the gain relates to residential property sold or gifted on or after 6 April 2020 any tax must be paid within 60 days of completion

That concludes this part so you should now understand:

- The basic principles of CGT
- Which assets are subject to CGT and which are exempt.
- Which transfers are exempt.
- How to calculate a CGT liability with and without losses
- When any CGT due must be paid to HMRC

Sources and further reading

https://www.gov.uk/capital-gains-tax
https://www.gov.uk/capital-gains-tax/report-and-pay-capital-gains-tax