

## AF1 Capital Gains Tax 2023/2024

### Part 3: Miscellaneous reliefs

A relief is a measure that reduces, defers, or wipes out the amount of CGT liability.

The milestones for this part are to understand:

- the special rules that apply to Chattels
- The Badges of Trade rules
- the rules for inter spousal transfers
- Business Asset Disposal Relief. (Formerly Entrepreneur's Relief)
- Investor's Relief
- When disposals qualify for holdover, rollover and incorporation relief

### Chattels

Chattels may sound a little Dickensian but it has a specific legal meaning. A chattel is tangible moveable property. Tangible means it must physically exist. A house or painting exist, a share does not since it merely confers the possibility that the investor will receive a dividend. Moveable means exactly that; the property can be moved from place to place. A house can never be a chattel but a painting is likely to be one. Note that if moveable property is permanently fixed to a building it ceases to be a chattel.

Chattels are exempt from CGT if they are sold for less than £6,000. This is the sale price, not the gain. This limit applies to each separate sale so if someone sells four paintings, two antique sofas and a piece of sculpture with each having a price of less than £6,000 no CGT is payable. Where the Revenue considers an item is part of a set, e.g. a collection of matching chairs is sold separately, they would take the price for the set as a whole in determining whether CGT was payable.

If the proceeds of the sale exceed £6,000 the profit becomes liable to CGT but this can be limited to  $\frac{5}{3} \times (\text{Gross proceeds less } £6,000)$  Note that using this formula any sale costs cannot be deducted.

Simon bought a painting for £100 in May 2001. It turned out to be more valuable than expected and was sold at auction in June 2018 for £9,000.

The gain is £8,900. However, applying the chattels rule the gain is limited to  $\frac{5}{3} \times (£9,000 \text{ less } £6,000) = £5,000$ .

If though the painting had been sold for £24,000, the chattels rule would have been of no value. The gain would have been £23,900 whereas using the chattels rule the gain would be  $\frac{5}{3} \times £18,000 = £30,000$ . The individual is free to choose whichever gives the lowest figure.

## CGT or Income Tax?

Whilst in principle there is no limit to the number of items that can be sold for less than £6,000, if this is done regularly with items being sold on shortly after purchase, HMRC will consider the individual is trading and tax the profits as income. In coming to a decision HMRC will apply what are termed the **Badges of Trade tests**. These are:

- Number and frequency of transactions
- A short interval between purchase and sale
- The asset was improved or modified to increase its value
- The nature of the asset
- The seller has a profit motive.
- Whether the asset was purchased or inherited. If the latter, then the seller would not normally be considered to be trading.

## Inter Spousal transfers

This also applies to civil partners and is a very valuable CGT planning tool. Inter spousal transfers are exempt and the benefits of this can be seen in the following examples.

Sandra and John aren't married but live together. Sandra holds some shares on which she calculates the potential tax liability is £20,000. If she were to transfer half of these to John she would be liable to CGT. John would be deemed to have acquired them at their market price at date of transfer.

Carol and Tom are married. She holds some shares on which she calculates the potential CGT liability is £12,000. If she were to transfer half of these to Tom she would not have to pay CGT. He would have acquired them at the price that Carol originally paid for them. He could choose to sell them making a gain of £6,000 which would be covered by the annual exemption.

In addition to being married or in a civil partnership, the couple must have lived together at some point in the tax year of the transfer. This is significant because couples normally separate before they divorce but inter spousal relief can only be claimed up to the end of the tax year of separation.

Raj and Sharma separated on 12<sup>th</sup> December 2022 but only divorced on 1<sup>st</sup> May 2023. Any assets transferred between them up to April 5 2023 will still get inter spousal relief. Any transfers after April 6 will not get relief even though they are still married.

Separating towards the end of the tax year can be disadvantageous.

Mike and Susan separated on March 1 2023. Only transfers up to 5<sup>th</sup> April 2023 will qualify for inter spousal relief.

If they had separated on April 25 2023, all transfers made up to 5 April 2024 would be exempt.

Once the divorce is absolute there can be no inter spousal relief.

Bill and Susan separated on May10 2023 and finalised their divorce on December 12 2023. Only transfers made prior to the divorce would get inter spousal relief.

### **Business Asset Disposal Relief (formerly called Entrepreneur's relief)**

Strictly speaking this is not a relief but rather a lower rate of 10% that is charged on the disposal of certain business assets. The most common example is when a sole trader sells their business.

To get the lower rate:

- It must be a trading business. Property or investment businesses aren't eligible.
- The seller must be a sole trader or business partner
- The individual must have owned the business for at least two years before it was sold.

If the business is structured as a business and shares are being sold the conditions are:

- The seller must have at least 5% of the shares and voting rights and be entitled to either:
  - 5% of the profits and assets available to equity holders on a winding up of the company
  - OR 5% of the sale proceeds had the whole of the share capital had the company been wound up on the day of disposal
- The seller is an employee or an office holder of the company for at least two years before the sale of the shares

If the business is being permanently closed all assets must be disposed of within three years of the business being sold.

The gain is calculated in the normal way but the rate is 10% regardless of the income of the individual. There is a lifetime limit on this relief of £1 million which applies to all disposals made on or after 11 March 2020.

Prior to this date the lifetime limit was £10 million and previous events must be considered in calculating the amount available in the current tax year.

Len made a gain of £600,000 in 2018 that qualified for Entrepreneur Relief. He started a new business which he sold in December 2023 making a gain of £800,000. Only £400,000 of the gain will qualify for the 10% Business Asset Disposal Relief. (£1m less £600,000)

Sheila sold her business in 2017 and made a gain of £2 million that qualified for Entrepreneur Relief. She started a new business and sold it in December 2022 making a gain of £500,000. She does not qualify for Business Asset Disposal Relief and all the gain will be charged standard rate.

If an individual makes a gain that qualifies for Business Asset Disposal Relief and another that is not, HMRC will allow the annual exemption to be used in whichever way is most tax efficient. This would normally be against the assets that don't qualify for BADR.

David is a higher rate taxpayer and has sold assets that qualify for BADR resulting in a gain of £200,000. He has also sold other assets resulting in a gain of £17,300.

Entrepreneur relief	£200,000 @ 10%	£20,000
Other assets	£17,300	
Less AE	<u>£6,000</u>	
	£11,300 @ 20%	<u>£2,260</u>
		£22,260

If an individual is a basic rate tax year and has two gains, the gain that qualifies for BADR must be offset against the remaining basic rate band.

Gina sold her nail manicure business in May 2023 making a gain of £40,000. In July 2023 she also sold a holiday home making a gain of £150,000. Her income is £30,000 short of the higher rate threshold.

Holiday home	£150,000
Less AE	<u>£6,000</u>
	£144,000

The business gain uses the remaining basic rate band of £30,000. £10,000 of the gain is in the higher rate band but the rate is still 10%,

Business	£40,000 @ 10%	£4,000
Holiday home	£144,000 @ 28%	<u>£40,320</u>
Total		£44,320

## Investor's Relief

Business Asset Disposal Relief cannot be claimed by an outside investor who is not an employee or an office holder. However, they can benefit from the 10% rate by claiming Investor's Relief.

Investors will qualify if

- They bought **new shares** for cash in an **unlisted trading company**
- on or after **March 17 2016**
- and held them **continuously for three years** (shares purchased between 17/3/16 & 5/4/16 must be held for three years starting on 6/4/16).

There is no need to have a 5% minimum of the authorised share capital nor be an employee or office holder. The lifetime limit is £10 million. This is separate to any claim for BADR in another business.

A claim for investor's relief must be made on the first anniversary of 31<sup>st</sup> January following the end of the tax year in which the gain was made.

Karim made a gain that qualified for IR in 2021/22. He must make the claim by January 31<sup>st</sup> 2023.

## Gift Holdover relief

Giving away an asset on which there is a gain means that the donor could face a tax bill even though they did not receive any money. There are two occasions when the donor can avoid paying the tax at the time of the gift:

- Gifting property into a **Relevant Property Trust**. This will be considered in the IHT section
- Gifting **business assets**.

Using this relief means:

- The donor doesn't pay CGT when the assets are given away
- The recipient pays CGT when they sell or dispose of the asset.
- The gain will be the disposal value less the value when the donor acquired them, not the value at the date of the gift.

Both the donor and recipient must claim this relief within four years following the end of the tax year in which the disposal was made.

Alan has shares in a private company that were valued in 1998 at £10,000. In the current tax year they were worth £30,000 and he gifted them to his son Simon. If both claim holdover relief there is no CGT at the time of the gift. Simon would be liable to pay CGT when he disposes of the shares and the acquisition price will be £10,000

Relief can only be claimed for assets in a trading business and not for a property or investment one. Holdover relief can apply to both business assets and shares.

If the donor is giving away business assets they must be:

- A sole trader or business partner OR have 5% of the shares and voting rights in a company. (known as "your personal company")
- Using the assets in the business

If shares are being gifted the shares:

- Must not be listed on any recognised stock exchange
- Must be in the donor's personal company

Partial Holdover Relief can also be claimed if an asset is sold for less than its market value.

Tom sells his café to his son for £400,000 although the market value is £800,000. Tom bought it originally for £300,000.

If holdover relief isn't claimed Tom will have made a gain of £500,000 (£800,000 less £300,000) and when his son comes to sell it, the acquisition value will be £800,000

If both agree to use holdover relief Tom's gain would be £100,000 (£400,000 less £300,000) and the acquisition value for any future disposal will be £400,000

## Business Asset Rollover relief

When an asset is sold CGT becomes payable even if all the proceeds are reinvested.

However, if a business sells assets and reinvests them into **trade or business** assets it is possible to defer the CGT until the new assets are sold.

Sarah runs a café and owns the premises. She wants to move to a bigger unit and will then sell the original premises.

The sale would normally be a CGT disposal but by claiming rollover relief the charge can be deferred until the new premises are sold. The acquisition price will be the acquisition price of the original premises.

Rollover relief can only be claimed if the new assets are purchased in the period one year before and three years after the sale of the original asset.

Tony buys new premises on June 1 2019. He then sells another building in May 2020. Rollover relief can be claimed. (purchase of new premises was less than 12 months before sale of old premises)

If the new building was purchased in April 2019 he could not claim rollover relief on the sale in May 2020 as this would be more than one year before the sale

If other assets are sold in July 2021, rollover relief can be claimed if the proceeds are reinvested into business assets by July 2024

## **Incorporation relief**

If a self-employed person incorporates the business and receives shares, technically it is a disposal. Claiming incorporation relief defers CGT until the new company is sold.

That concludes this chapter so you should now:

- the special rules that apply to Chattels
- The Badges of Trade rules
- the rules for inter spousal transfers
- Business Asset Disposal Relief. (Formerly Entrepreneur's Relief)
- Investor's Relief
- When disposals qualify for holdover, rollover and incorporation relief

## **Sources and Further Reading**

<https://www.gov.uk/capital-gains-tax/gifts>

<https://www.gov.uk/business-asset-disposal-relief>

<https://www.accaglobal.com/us/en/technical-activities/technical-resources-search/2018/april/capital-gains-and-chattels.html>

<https://www.jonathanlea.net/2018/what-is-investors-relief-and-how-does-it-work/>

<https://www.gov.uk/gift-holdover-relief>

<https://www.gov.uk/business-asset-rollover-relief>

## **Amendment log**

July 22 Holdover relief. Table on page 6 reworded to make the example clearer.