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An Introduction to Capital Gains Tax

This is one of a series of Fact Sheets provided by J. & H. Mitchell W.S.

Capital Gains Tax is payable on lifetime disposals of assets based on the gain in value between 31st March 1982 (or later date of acquisition) and disposal. Death wipes out any inherent capital gain for CGT purposes and beneficiaries of assets from a deceased person's estate are normally treated as acquiring assets at the date of death value.

Capital Gains Tax is payable at 18% or 28%, depending on whether the taxpayer is a Basic Rate or Higher Rate taxpayer for Income Tax purposes. The capital gain is added to the taxpayer's income for the tax year in question for the purpose of assessing which rate applies.

Each individual has an annual Capital Gains Tax exemption (£11,000 for the 2014/15 tax year). For most Trusts the annual exemption is one-half of an individual's exemption, thus £5,500 (2014/15) and the tax rate for Trusts is 28%.

Capital Gains Tax can be a major problem for lifetime disposals. One can be faced with a choice, on the one hand, of holding assets for life in which case Inheritance Tax will be payable on death (but Capital Gains Tax will not be payable) or, on the other hand, of making lifetime disposals which may avoid Inheritance Tax (where the donor survives for seven years after the gift) but where Capital Gains Tax may be payable on the gain between acquisition and the date of the gift.

There is a Capital Gains Tax exemption for chattels, i.e. pictures, furniture and other objects, where the value of the object in question does not exceed £6,000. There are also Capital Gains Tax exemptions for a number of specific assets such as prizes, most motor cars and compensatory payments.

No Capital Gains Tax is chargeable on gifts between husband and wife, and the recipient in that case is treated as having acquired it at the date and value of his or her spouse's acquisition. There is also no Capital Gains tax on gifts to charities and to registered Community Amateur Sports Clubs. Where gifts are made to "connected persons" (family members and business colleagues), the donor is treated as having sold the asset at open market value and the recipient as having acquired the asset at open market value on the date of gift and Capital Gains Tax will be charged accordingly.

There are some important reliefs which can reduce or defer Capital Gains Tax liability. The three most important reliefs are:-

1. **Entrepreneurs' Relief** is available for disposals of business assets. It can apply also to the disposal of shares or an interest in a business partnership. For disposals after 5th April 2011 it is limited to aggregate gains of £10million over an individual's lifetime. This relief reduces the rate at which Capital Gains Tax is chargeable from 18% to 10%.
2. **Roll-over Relief** allows relief from Capital Gains Tax where one business asset is disposed of and is replaced by another business asset (not necessarily in the same business) within a period of one year before the disposal and three years after the disposal. This relief is also available where land is compulsorily purchased (e.g. for a public road).
3. **Gifts Relief (also known as Hold-over Relief)** is available where a gift is made of either business or agricultural assets, or of heritage property or works of art. It is also available where a gift is made to a political party, to fund heritage maintenance or to most types of trust (although it should be noted that gifts to trusts usually incur immediate payment of Inheritance Tax). This relief has the result that the donee is treated as having acquired the asset at the date and value of the donor's acquisition.

THE 'PRINCIPAL PRIVATE RESIDENCE' EXEMPTION FROM CAPITAL GAINS TAX

For the Principal Private Residence exemption (PPR) apply, which would ensure that a sale of your home is free of Capital Gains Tax (CGT), the property (dwelling house) must be your only or main residence throughout the period of ownership.

If the property has been your only or main residence for part only of your ownership (excepting the last three years - see below) then, subject to various detailed provisions in the legislation, the total gain is apportioned between the period of your occupation (exempt) and the period when you did not occupy it (taxable).

The PPR exemption extends to:

(a) other ancillary buildings occupied for the purpose of the main residence (e.g. shed, summerhouse, staff bungalow); and

(b) gardens and grounds of up to half an hectare (inclusive of the house itself) - although a larger area can be included if this is appropriate for the style and character of the house.

The PPR exemption is for one property per person only; so if you acquire another property, you will have to make an election as to which property is to be exempt and which is not. The election must be made within 2 years of the date that the situation arose. If one house is replaced then a new 2 year period begins. As owner, you must actually reside in both properties for some time at least and any period of ownership not elected as the PPR will obviously be chargeable.

The situation becomes complicated on marriage. A newly married couple may be unaware of the potential CGT bill due when one of them comes to sell his or her house, owned and lived in prior to the marriage. As a married couple live together, they are treated as one person, so an election has to be made within 2 years of the marriage as to which residence is the one to be exempt - and the election has to be made by both as a joint election. If a couple misses the two year deadline, it is the Inland Revenue who will choose which property is exempt on facts presented to them.

There is no minimum period of occupation for PPR, but the house has to be occupied before and after any period of absence unless the reason for the absence was that the owner was working away. In that event, he or she does not have to go back to the house if the work subsequently requires him or her to reside elsewhere. If the reason for the absence is working abroad, then any period of absence, no matter for how long, is allowable. If working elsewhere within the UK, a worker is allowed an absence of only four years.

Some relief is available for all these unusual circumstances in that the first year and the last three of ownership are always treated as periods of occupation, irrespective of whether actual occupation takes place. This valuable exemption helps to cover situations where it takes a long time to sell a house and find somewhere else to live.

The three year exemption is extended indefinitely in the situation where a married couple separate, otherwise without exemption problems could arise where one spouse leaves the property and conveys the interest to the other at a later date.

Similarly, another concession extends the first year rule. Where an individual either buys land and builds a house on it, living somewhere else in the meantime or arranges alterations on a house before moving in, then he or she is regarded as being in occupation provided that the work is completed within 12 months. In exceptional cases the 12 months can be extended to 2 years. He or she has to occupy the property after the works are completed.

In effect these concessions mean that if you move out of your main home but then sell it within three years thereafter, that period of absence before the sale will not prejudice the tax exemption. Similarly, if you buy a house and do not move in straight away, perhaps because you are still selling your last house, or are having renovation works done to the new one, you will remain eligible for the exemption from the date of purchase provided that you move in within twelve months thereafter.

Specific advice is available on any particular set of circumstances.

Although carefully prepared, this Fact Sheet is a guide only

and is not intended to be comprehensive.

Specific advice should be requested on your own individual situation.

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