CHAPTER 1

INTRODUCTION TO CAPITAL GAINS TAX

All statutory references are to the Taxation of Chargeable Gains Act (TCGA) 1992 unless stated otherwise.

1.1 Introduction

Capital gains tax is a relatively new tax, having been introduced on 6 April 1965. The legislation has been amended considerably several times since it was introduced. The most recent changes were made in the second budget of 2010.

In general terms a **capital gain** will arise when a person disposes of a **capital asset** at a **profit**. Profit, again in general terms, is the excess of proceeds over cost.

A charge to capital gains tax will arise when a chargeable person makes a chargeable disposal of a chargeable asset.

1.2 Chargeable person

A chargeable person could be an individual or it could be a company. Note here, however, that if a company makes a capital gain - it will not pay capital gains tax but instead the **company will pay corporation tax on its gain**.

TCGA 1992, s. 1

If an individual is either **resident** in the UK **or ordinarily resident** in the UK they will be chargeable to capital gains tax. The meaning of resident and ordinarily resident is the same as for income tax.

TCGA 1992, s. 2(1)

Generally, individuals who are neither resident nor ordinarily resident in the UK do not pay UK capital gains tax even if they sell an asset that is situated in the UK.

1.3 Chargeable disposal

The most common way for a person to dispose of an asset is to **sell** it to another person. However, a **gift** also constitutes a disposal for capital gains tax purposes. There are provisions within the capital gains tax legislation that provide for the **loss or destruction** of an asset also to be treated as a disposal for CGT.

TCGA 1992, s. 22(1)(a)

1.4 Chargeable assets

Most property other than cash in sterling is an asset for CGT purposes. An asset is a chargeable asset if it is **not specifically exempt** under the capital gains tax legislation. If you cannot find an asset on the list of exempt assets, it will be a chargeable asset for capital gains tax purposes.

TCGA 1992, s. 21(1)

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1.5 Exempt assets

Cars are always exempt from capital gains tax. The legislation defines a car as a "mechanically propelled road vehicle suitable for the conveyance of passengers". As such, assets such as vans and lorries are not exempt from CGT, because they do not satisfy the definition of the word "car".

TCGA 1992, s. 263

Wasting chattels are exempt from CGT. A chattel is "tangible, moveable property" – i.e., an asset that one can see, touch and move. A wasting chattel is a chattel with a useful life of not more than fifty years. Assets such as greyhounds and racehorses are exempt from CGT.

TCGA 1992, s. 45

TCGA 1992, s. 262

Gilts are also exempt from CGT. Gilts are Treasury Stock issued by the UK Government on which annual interest is payable. Gilts are exempt from capital gains tax because they will satisfy the definition of a Qualifying Corporate Bond (QCB). QCBs are exempt assets for CGT.

TCGA 1992, s. 115

TCGA 1992, s.117

Shares in an **ISA** (Individual Savings Account) are exempt as are shares in **VCTs** (Venture Capital Trusts). Gains on shares in **EIS** companies are also exempt but subject to certain conditions.

SI 1998/1870

TCGA 1992, s. 151A

This is not an exhaustive list and there are one or two other assets that are also exempt from capital gains tax. These include foreign currency held for personal expenditure outside the UK, certain decorations for valour, life assurance policies and certain works of art. Remember if an asset is not specifically exempt, it must be a chargeable asset for capital gains tax.

Annex to SP 4/92

TCGA 1992, s. 258

1.6 Transfers between spouses and civil partners

Any transfer between a husband and wife is treated as taking place at no gain and no loss. This means that spouses can transfer assets freely between them, without incurring a charge to CGT. The same rule applies to civil partners.

TCGA 1992, s. 58

Inter-spouse transfers are covered in detail in a later chapter.

1.7 Gifts to charities and political parties

Gains on gifts of assets, or sales of assets at an undervalue, to charities or to political parties, are also treated as taking place at no gain and no loss.

TCGA 1992, s. 257

1.8 Annual exemption

Every individual has an annual exemption for capital gains tax. This annual exemption is **£10,100** for the tax year 2010/11. The annual exemption is similar to the personal allowance for income tax in that the first £10,100 of capital gains in the year are not chargeable to CGT. Therefore, in order to arrive at taxable gains, we take chargeable gains and deduct £10,100.

TCGA 1992, s. 3

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Illustration 1

Charlie sold a statue on 7 April 2010 giving rise to a gain of £8,500. He also sold some shares in AOK plc on 8 May 2010 giving rise to a gain of £12,600

To arrive at Charlie's taxable gains for 2010/11, we deduct the annual exemption from his total chargeable gains:

	£
Gain on statue	8,500
Gain on shares	12,600
Total chargeable gains	21,100
Less: Annual Exemption	(10,100)
Taxable gain for 2010/11	£11,000

1.9 Calculation of CGT

The way in which gains arising in 2010/11 and future years are taxed was amended as a result of the second Budget of 2010.

Taxable gains arising before 23 June 2010 are charged at a fixed rate of capital gains tax of 18%. This is irrespective of the amount of the gains, or the amount of income received in the tax year.

TCGA 1992, s. 4

For taxable gains arising on or after 23 June 2010, the rate of capital gains tax depends on **the level of an individual's taxable income.**

If an individual pays tax at the higher (or additional) rate on his income, then the rate of capital gains tax will be 28%. Otherwise, gains will be taxed at a rate of 18% to the extent that they do not exceed the individuals unused basic rate band and at 28% to the extent that they exceed the amount of the unused basic rate band.

The unused basic rate band is the **amount of basic rate band remaining after an individual's income has been taxed**. Remember that the basic rate band will be extended by the gross amount of any gift aid donations or personal pension contributions made by the individual.

The **annual exemption should be deducted in order to minimise the tax** due. In other words, it should be deducted from gains which are subject to tax at the highest rate.

When calculating an individual's capital gains tax liability for 2010/11, gains arising before 23 June 2010 will be taxed at 18%, regardless of the level of an individual's income. In order to calculate the tax on gains arising on or after 23 June 2010, it will be necessary to establish the amount of the unused basic rate band. The annual exemption should be allocated to gains arising on or after 23 June 2010 where these will be chargeable at a rate of 28%.

Illustration 2

George sold a painting on 3 May 2010 giving rise to a gain of £20,000. He also sold an investment property on 31 August 2010 giving rise to a gain of £50,000.

George works as a financial controller and earns £35,000 per annum. This is his only source of income in 2010/11.

In order to calculate his capital gains tax liability for 2010/11, we need to deal with each gain separately as one arose prior to 23 June 2010 and the other after this date.

	Before 23 June 2010	On or after 23 June 2010
	£	£
Painting	20,000	
Investment property		50,000
Less: AE		(10,100)
Taxable gains	20,000	39,900

The annual exemption is used to offset the later gain as this will save tax at a higher rate.

The gain of £20,000 arising before 23 June 2010 will be taxed at 18%. In order to calculate the tax due on the gain of £39,900, we need to establish the amount of George's unused basic rate band.

	£
Salary	35,000
Less: PA	(6,475)
Taxable Income	28,525

	£
Basic rate band	37,400
Less: taxable income	(28,525)
Unused amount	8,875

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	Before 23 June 2010	On or after 23 June 2010
	£	£
Taxable gains	20,000	39,900
CGT:		
20,000 @ 18%	3,600	
8,875 @ 18%		1,597
31,025 @ 28%		8,687
35,000		10,284
Total CGT liability	£13,884	

1.10 Due date

Capital gains tax is always due and payable in full on **31 January** following the year in which the gain was made. For 2010/11, the CGT will be due and payable on 31 January 2012.

TMA 1970, s. 59B

Example 1

Indicate whether the following assets are chargeable or exempt.

	Chargeable	*Exempt*
a) Cottage in Lake District		
b) Villa in Spain		
c) Antique vase		
d) Vintage Rolls Royce		
e) Shares in Tolley Ltd		
f) Shares in an ISA		
g) Thoroughbred racehorse		
h) National Lottery ticket		
i) Factory used for business		

Example 2

Vince is a Civil Servant earning £32,625 per annum. In 2010/11 he sold 2 assets:

1. Shares in ICI plc on 1 December 2010 realising a gain of £15,000.

2. A plot of land on 1 March 2011 realising a gain of £45,000.

Vince made a donation of £500 to the World Wildlife Fund via Gift Aid on 1 May 2010.

Calculate Vince's CGT liability for 2010/11.

Example 3

Assume that Vince (Example 2 above) sold the ICI plc shares on 1 June 2010.

Calculate Vince's CGT liability for 2010/11.

Answer 1

	Chargeable	Exempt
a) Cottage in Lake District	✓	
b) Villa in Spain	✓	
c) Antique vase	✓	
d) Vintage Rolls Royce		✓
e) Shares in Tolley Ltd	✓	
f) Shares in an ISA		✓
g) Thoroughbred racehorse		✓
h) National lottery ticket		✓
i) Factory used for business	✓	

Answer 2

Capital gains:	£
Shares	15,000
Land	45,000
	60,000
Less: AE	(10,100)
Taxable gains	49,900

CGT:	£
£11,875 @ 18% (W1)	2,137
£38,025 @ 28%	10,647
CGT payable	12,784

W1:	£
Salary	32,625
Less: PA	(6,475)
Taxable Income	26,150

	£
Basic rate band(W2)	38,025
Less: taxable income	(26,150)
Unused amount	11,875

W2:	
Basic rate band	37,400
Add: extension for Gift Aid (£500 x 10/80)	625
	38,025

Answer 3

	Before 23 June 2010	On or after 23 June 2010
	£	£
Shares	15,000	
Land		45,000
Less: AE		(10,100)
Taxable gains	15,000	34,900
CGT:		
£15,000 @ 18%	2,700	
£11,875 @ 18% (Answer 2, W1)		2,137
£23,025 @ 28%		6,447
£34,900		8,584
	£11,284	

Note:

Gains made before 23 June 2010 are taxed at 18%.

The annual exemption is allocated to the gain arising after 23 June 2010 as this suffers tax at the highest rate.