CHAPTER 2

CALCULATION OF CAPITAL GAINS

2.1 Introduction

FA 2008 introduced changes which aimed to simplify the way in which gains are calculated.

2.2 Calculation of gains

The method of calculating the capital gain on assets disposed of is very straightforward.

	£
Proceeds of sale	P
Less: Costs of acquisition	(C)
Capital gain	G

We simply **take proceeds of sale and deduct all costs of acquisition** to leave us with the capital gain.

In essence, we are simply working out the cash profit on the transaction.

From the proceeds of sale we may deduct **incidental costs of disposal.** These will include legal fees, valuation fees, and any costs of advertising for sale.

Similarly the costs of acquiring an asset will include allowable costs and expenses. These allowable costs will obviously include the actual cost of acquiring the asset in the first place. An asset which is inherited is treated as being acquired at probate value. To this we need to add on any **enhancement expenditure** - that is expenditure which enhances or improves the value of the asset. In addition to this we can include any **associated expenses** such as legal fees, commissions and stamp duty reserve tax or stamp duty land tax. TCGA 1992, s. 38

Illustration 1

In June 2002, Dave bought a house at a cost of £100,000. Legal fees in acquiring the property amounted to £5,000. In December 2002 Dave added a conservatory to the house at a cost of £20,000. In May 2010, Dave sold the house and his proceeds of sale were £200,000. Dave incurred estate agent's fees of £4,000 on the sale.

In order to calculate Dave's capital gain on the sale of the property, we start with the gross proceeds of sale. From this we deduct the selling expenses - i.e. the estate agent's fees on sale, to leave net proceeds of sale. From net proceeds we deduct costs of acquisition. These are the initial purchase cost, legal fees on purchase and the costs of the conservatory – i.e. the enhancement expenditure.

	£
Gross proceeds	200,000
Less: selling expenses	(4,000)
Net proceeds	196,000
Less: costs of acquisition	
purchase cost	(100,000)
legal fees	(5,000)
enhancement expenditure	(20,000)
Capital gain	£71,000

You will note here that Dave is simply paying capital gains tax on his cash gain. £71,000 is the difference between the cash that he receives and the total cash that he has spent. This capital gain will then be taxed by deducting the annual exemption of £10,100 and charging the remaining taxable gain at 18% - the fixed rate of CGT for disposals before 23 June 2010.

2.3 March 1982 Rebasing

TCGA 1992, s. 35

Where the asset was originally acquired before 31 March 1982, instead of deducting original cost, we **deduct the value of the asset as at 31 March 1982** when calculating the capital gain.

In effect we are pretending that we bought the asset on 31 March 1982 for its market value at that date. TCGA 1992, s. 35(2)

2010/11 disposal	£
Proceeds	P
Less: March 1982 value	(MV82)
Capital gain	G

This is what we mean by "March 1982 rebasing" – i.e. we are using March 1982 as a "base" from which to calculate capital gains.

Illustration 2

Connie, a higher-rate taxpayer, purchased a house in June 1978 for £15,000. In March 1982 the house was worth £25,000. Connie sold the house in February 2011 for gross proceeds of £100,000. She incurred estate agents' fees of £1,500 on the sale.

	£
Proceeds	100,000
Less: fees	(1,500)
Net proceeds	98,500
Less: 1982 value	(25,000)
Capital gain	73,500

The disposal occurred on or after 23 June 2010. As Connie has no basic rate band remaining the gain, after deduction of the annual exemption, will be taxed at 28%.

2.4 Post transaction valuations

In practice it can be difficult obtaining valuations for assets such as shares in unquoted companies and the value of assets held at March 1982.

Taxpayers can ask their Tax Office to check any valuations that they have used to compute their capital gains liability. This check is done after the disposal is made but before the tax return is submitted to HMRC. PR 4/2/97

Form CG34 sets out the information and documents which need to be supplied to HMRC.

Where HMRC agree on a valuation with the taxpayer, HMRC will only challenge the valuation where it comes to light that important facts affecting the valuation have not been notified to HMRC.

If the taxpayer cannot reach agreement after discussion with HMRC on any valuation, the taxpayer may appeal to the Tribunal.

Example 1

Trevor bought a house in April 1989 for £40,000. The legal fees on purchase were £2,000. He sells the house in August 2010 for £150,000 and the agent's fees on sale are £6,000.

Trevor has no taxable income in 2010/11.

Calculate Trevor's CGT liability for 2010/11.

Example 2

Jennifer buys a painting in January 1993 for £15,000 and sells it in September 2010 for £50,000.

Jennifer has employment income of £26,000 in 2010/11. Her employment ceased on 31 May 2010. She has no other income in 2010/11.

Calculate Jennifer's CGT liability for 2010/11 and state the due date for payment.

Example 3

Derek bought a holiday cottage in the Lake District in 1977 for £45,000. It was valued at £48,000 in March 1982. Derek sold the cottage in December 2010 for £86,000.

Calculate Derek's capital gain for 2010/11.

Answer 1

	£	£
Gross proceeds of sale		150,000
Less: costs of disposal		(6,000)
		144,000
Cost of purchase	40,000	
Add: legal fees	2,000	
		(42,000)
Capital gain		102,000
Less: annual exemption		(10,100)
		91,900
CGT:		
£37,400 @ 18%		6,732
£54,500 @ 28%		15,260
Total CGT due		£21,992

Answer 2

	£
Proceeds	50,000
Less: cost	(15,000)
Capital gain	35,000
Less: annual exemption	(10,100)
Taxable gain	£24,900

	£
CGT :	
£17,875 @ 18% (W)	3,218
£7,025 @ 28%	1,967
Total CGT due 31.1.12	£5,185

W

Basic rate band	37,400
Less: taxable income (£26,000 - £6,475)	(19,525)
Basic rate band remaining	17,875

Answer 3

	£
Proceeds	86,000
1982 value	(48,000)
Capital gain	£38,000