Chapter 12

CAPITAL GAINS TAX – INDIVIDUALS

1 Individuals and Companies

Individuals pay Capital Gains Tax (CGT) on their chargeable gains of the tax year, whereas the chargeable gains of a company are included on the company's Corporation Tax Computation along with its other taxable income and the company's overall taxable total profits are then subjected to Corporation Tax, as you will see later in these course notes.

A chargeable gain or allowable loss arises on a chargeable disposal of a chargeable asset by a chargeable person.

The basic calculation of the chargeable gain is a simple one, deducting the allowable costs of an asset from its net proceeds upon its sale. A company NOT an individual may then further reduce any gain for the effects of inflation by the deduction of Indexation Allowance.

Qualifying gains may then be eligible for certain reliefs that will allow such gains or parts thereof to be either exempted from tax or and more commonly, deferred from immediate chargeability to tax.

1.1 Chargeable Disposal

A chargeable disposal will usually occur by the sale of an asset but will also arise when an asset is gifted, lost or destroyed. There is no chargeable disposal upon the death of the taxpayer, however, and assets will pass free of CGT to the beneficiaries at their market (probate) value. Sadly, although no CGT arises upon death, a chargeability to Inheritance Tax (IHT) may arise (see chapter 23).

1.2 Chargeable Assets

All assets are chargeable unless specifically exempted.

Exempt assets include:

- Motor vehicles suitable for private use
- National Savings & Investment certificates
- Foreign currency for private use
- Decorations awarded for bravery
- Damages for personal injury
- Life insurance policies
- Works of art given for national use
- Gilt edged securities (Government Securities such as Exchequer Stock)
- Qualifying Corporate Bonds (Corporate loan stock)
- Certain Chattels (tangible moveable property)
- Investments held in an ISA

1.3 Chargeable Person

An individual who is resident in the UK is a Chargeable Person and is therefore liable on their worldwide assets.

1.4 CGT computation

(a) Capital gains and losses are aggregated for each tax year.

(b) Basic capital gains computation

Capital Gains in tax year	X
Less: Capital losses in tax year	(X)
Net Capital Gains in tax year	X
Less: Capital losses brought forward	(X)
Net Capital Gains	X
Less Annual exemption	(11,000)
Taxable Gains	X
CGT × 10%, 18% or 28%	X
Due (for 2014/15)	31/1/16

A chargeable gain or allowable loss of an individual is computed as follows:

Disposal proceeds	X
Less: Incidental cost of disposal	(X)
Net proceeds	X
Less: Costs	(X)
Capital Gain / (Capital loss)	X / (X)

Individuals do not get indexation allowance on disposals as companies do, but they do benefit from an Annual Exemption which is not available to companies.

1.5 Annual exemption

(a) Every individual has an exempt amount for each tax year. For 2014/15 it is £11,000

(b) If the annual exemption is not used it is wasted.

1.6 Payment of CGT

CGT is due in one amount on 31 January following the tax year (2014/15 by 31 January 2016)

No payments on account of the CGT liability are required.

1.7 Rates of CGT

(a) The capital gains tax rates are determined by either the taxable level of a persons income or the availability of entrepreneurs relief. If entrepreneurs relief is available, then on those gains qualifying a CGT rate of 10% is applied.

(b) The taxpayer's Taxable Income from his Income tax Computation is then used as the basis for applying the relevant CGT rates to his figure of Taxable Gains. After considering a persons taxable income from their Income Tax Computation a CGT rate of 18% is applied on those taxable gains that fall into any remaining basic rate band (or extended basic rate band if the person makes gift aid donations or pays personal pension contributions).

(c) After considering a persons taxable income, a CGT rate of 28% is then applied on those gains in excess of the basic rate band (or extended).

For example if the taxpayer had taxable gains of £15,000 (none qualifying for entrepreneurs relief) and taxable income of £21,865, then the first £10,000 of his taxable gains would use up his remaining basic rate band (31,865 - 21,865) and be taxed at 18% leaving £5,000 of his taxable gains to be taxed at 28%

Example 1

Tina sold a painting on 1 July 2014 for £500,000. She purchased the painting in February 1997 for £350,000.
She also disposed of an investment property for £310,000 on 1 December 2014 and incurred agency fees of £15,000 on the disposal. She had purchased the property in August 1998 for £200,000.
In addition she sold an antique vase for £10,000 in January 2015 which had cost her £15,000 in September 2012.
Tina had capital losses brought forward from previous tax years of £12,000. Tina's taxable income for 2014/15 is £50,000.

Calculate Tina's Capital Gains Tax for 2014/15

Example 2

Matthew has trading profit of £20,000 assessed in 2014/15 and sold an antique vase giving rise to a capital gain of £18,000.

Calculate Matthew's capital gains tax for 2014/15

Example 3

Katie has trading profit of £40,000 assessed in 2014/15. In addition she sold an investment property giving rise to a capital gain of £30,000.

Calculate Katie's capital gains tax for 2014/15

Example 4

Elliot has trading profit of £44,000 assessed in 2014/15. In addition he sold a painting giving rise to a capital gain of £26,000. He made a gift aid payment of £2,400 in 2014/15.

Calculate Elliot's capital gains tax for 2014/15

1.8 Disposal proceeds

Actual consideration is used when the bargain is made at arm's length.

Market value is used in other cases for example when the disposal is a gift

When quoted shares are gifted the value may not be given in the exam and needs to be calculated using the **lower of**

(a) the quarter up rule, [lowest price + ¼ (highest price – lowest price)] or

(b) mid bargain price [Average of highest and lowest marked bargains]

Example 5

Jenny gifted 1,000 shares in M plc when they were quoted at 400 - 408p and the marked bargain prices were 399, 400, 403, 407, 408

Calculate the value to be used for capital gains disposal proceeds

1.9 Incidental costs would include:

- **(a)** legal fees
- **(b)** advertising fees
- **(c)** auctioneers fees
- **(d)** agency fees

1.10 Costs

Costs include:

- **(a)** the cost of acquisition and any incidental costs of acquisition
- **(b)** expenditure on enhancing the value of the asset (improvement expenditure)

The exception is when an individual acquires an asset where the previous owner had to use the asset's market value for his disposal proceeds, then the current owner must use the same market value as his cost of acquisition.

2 Losses

- **(a)** Where capital losses arise they are set against capital gains in the same tax year.
- **(b)** The set off is made to the maximum possible extent – it cannot be restricted to avoid wasting the annual exemption
- **(c)** If there are insufficient gains to set off the capital losses in the year they arise, the unrelieved capital losses may be carried forward.
- **(d)** Current year capital losses are deducted in priority to capital losses brought forward. The capital losses brought forward, however only reduce capital gains to the level of the annual exemption, and therefore do not waste the annual exemption
- **(e)** Any unrelieved capital losses brought forward are carried forward to the next tax year.

Example 6

Fiona and Jane made capital gains and capital losses for the years 2013/14 and 2014/15 as set out below:

	Fiona	*Jane*
2013/14		
Capital gains	15,000	7,000
Capital losses	10,000	10,000
2014/15		
Capital gains	17,000	13,700
Capital losses	5,200	2,000

Calculate the taxable gains for Fiona and Jane for both 2013/14 and 2014/15 and the amount of any losses carried forward at the end of 2014/15

3 Transfer of assets between a husband and wife or between civil partners

The transfer of assets between spouses and civil partners is for CGT purposes deemed to take place at a value that would give rise to neither a gain nor a loss. The transfer is said to be a nil gain/ nil loss or no gain / no loss transfer. Essentially the transferor is deemed to make the disposal at cost and the transferee acquires the asset at the original cost of the transferor.

The Nil gain / Nil loss transfer rules may be used by these taxpayers to utilize both parties annual exemptions, and to take advantage of capital losses and lower capital gains tax rates. For example it would be better for each spouse to yield gains of £10,000 each rather than one spouse make gains of £20,000. It would also be better for a basic rate taxpayer to yield taxable gains, taxed at 18% instead of a higher rate taxpayer who would be taxed at 28% on the same gains.

Example 7

Mike bought a ring in July 1993 for £12,000. He transferred it to his wife Barbara in December 2014. Barbara sold the ring in January 2015 for £20,000.

Calculate Barbara's capital gain in 2014/15

4 Part Disposals

(a) A chargeable asset may be only partly disposed of, for example a taxpayer acquires 100 hectares of land and subsequently goes on to sell 40 of those hectares. This will give rise to a chargeable gain computed in the normal way, but a specific problem arises however regarding what figure of cost should be used in the gains calculation. It may seem appropriate to use 40/100 of the original cost, given the quantity of land purchased and then sold. This, however is not the basis used and a value based apportionement of the total cost should instead be used

(b) The cost of the whole asset is apportioned using the formula:

$$\frac{A}{A + B}$$

where:

A – Gross proceeds of part disposed

B – Market value of the remainder of the asset (this will be given in the question)

Example 8

ST owned 10 hectares of land which originally cost £26,000 in March 2012. ST sold 2 hectares of the land in December 2014 for £16,000. The remaining 8 hectares were valued at £34,000 in December 2014.

Calculate the chargeable gain on the disposal of the 2 hectares of land in December 2014

5 Chattels

(a) A chattel is a tangible moveable asset

(b) A wasting chattel is one with an estimated remaining life of 50 years or less. These are exempt from chargeable gains & losses. Examples include racehorses, greyhounds (dogs) and yachts (boats).

(c) There is an exception for plant & machinery on which capital allowances have been claimed, these assets are treated as non wasting chattels. If plant and machinery is not covered by the non wasting chattel exemption in note (d) below, then a gain would need to be computed upon its disposal. Such a calculation is seldom required however as it would normally be sold for less than cost. A capital loss will not however arise in this situation as capital allowances will already have given tax relief for the net cost of ownership of the asset.

(d) A non wasting chattel is one with an estimated remaining life of more than 50 years. Examples include antiques and paintings. There are special rules to determine the chargeable gain or capital loss.

Cost	**Proceeds**	**Treatment**
≤ £6,000	≤ £6,000	Exempt
≤ £6,000	> £6,000	Normal calculation but the gain is restricted to a maximum 5/3 x [Gross proceeds – 6,000]
> £6,000	<£6,000	Deemed Gross Proceeds = £6,000
> £6,000	> £6,000	Normal calculation

Example 9

JM sold the following assets in December 2014

(a) an antique table which had cost £3,000 in February 2009 and sold for £5,000

(b) a painting which had cost £2,000 in January 2012 and sold for £10,000

(c) an antique vase which had cost £8,000 in August 2002 and sold for £3,000

(d) a vintage car which had cost £7,000 in July 1999 and sold for £9,000

Calculate the net chargeable gains or losses arising for JM in December 2014

6 Other wasting assets (that are not chattels)

An example of a wasting asset which are not chattels are copyrights.

The allowable expenditure is deemed to waste away over the life of the asset.

When a disposal is made, the allowable expenditure is restricted to take account of the assets natural fall in value. This fall in value is deemed to occur on a straight line basis over its predictable useful life.

The original cost is therefore reduced BY

$$\frac{P}{L} \times (C - S)$$

where

P = Period of ownership of seller

L = Predictable Life of asset on acquisition

C = Cost of the asset

S = Scrap / residual value at the end of the assets' predictable life

EXAMPLE 10

On 1 December 2002 Z bought a copyright at a cost of £25,000. It had an estimated useful life of 30 years, and an estimated residual value of £1,000.
Z sold the asset for £38,000 on 1 December 2014.

Calculate the chargeable gain arising on the sale of the copyright in December 2014.

You should now attempt Practice Questions 29 & 30