



2007 pre-budget speech – Capital Tax client update

Capital Gains Tax

A major reform of Capital Gains Tax has been announced which introduces the most radical changes to capital gains tax for twenty five years, to take effect from April 2008. Taper Relief and Indexation will be abolished, and there will be a single rate for Capital Gains Tax of 18% for all. Annual Exemptions (currently £9,200) will continue to be available to offset against capital gains. The complex share matching and pooling rules are also being abolished, and replaced from April 2008. All shares of the same class in the same company will form a single pool, although same day and bed and breakfasting rules continue.

There will be winners and losers under these new rules, and unfortunately in many cases it will be the business owners that lose out.

Take for example a higher rate taxpaying farmer who purchased land in 1982 for £50,000. If this land were sold for £200,000, the following calculations show the difference in tax for a sale taking place before or after 6 April 08.

	Pre 6 April 08	Post 6 April 08
Proceeds	£200,000	£200,000
Less Cost	(£50,000)	(£50,000)
Less Indexation	(£52,350)	–
Less Business Asset Taper	(£73,238)	–
Taxable Gain	£24,412	£150,000
Tax at 40% / 18%	£9,765	£27,000

In this instance the farmer will pay almost three times the amount of tax if he waits and sells the land after 6 April 2008. This position will be similar for most business assets, including shares in unquoted trading companies, particularly where the asset has been held for at least two years.

However the position may well improve for owners of non-business assets, particularly if they have been owned for a relatively short period of time. For example, a higher rate taxpaying individual sells a buy to let property for £200,000 that he had purchased two years previously for £150,000. The position comparing a sale before and after 6 April 2008 is as follows:

	Pre 6 April 08	Post 6 April 08
Proceeds	£200,000	£200,000
Less Cost	(£150,000)	(£150,000)
Taxable Gain	£50,000	£50,000
Tax at 40% / 18%	£20,000	£9,000

In this instance the tax would more than halve, just by waiting a few months to dispose of the asset. Where an asset will not qualify for Business Asset Taper relief and been held for less than three years, an individual will always be better off waiting until the new rules take effect before selling (not taking the annual exemption into account). This will also be the position for quoted shares.

As demonstrated in the two examples, some people will pay more tax, and others less under the new rules. These examples show the extremes, but many individuals may fall somewhere between the two, and it is vital where a sale is being contemplated to consider which side of the year end the transaction should fall.

There are other variables that will complicate the calculations, so unfortunately there are no hard and fast rules that can be applied. Where it is anticipated that a significant gain will be made on disposal of an asset, we strongly recommend that professional advice is sought.



Even where there are no plans to sell an asset in the near future, it may be possible to lock in the indexation and taper relief benefits where these are significant.

This is a major simplification of Capital Gains Tax. We have a window of opportunity until 5 April 2008 to consider whether those that benefit more under the current regime should take any action.

Inheritance Tax

Inheritance Tax has been simplified for married couples and civil partners, in that any unused nil rate band on the death of the first spouse can be transferred to the surviving spouse to utilise on their death. This will effectively give couples a joint nil rate band of £600,000, and will avoid the need for discretionary nil rate band will planning. The Chancellor also announced that this limit will increase to £700,000 by 2010/11.

This new rule takes immediate effect, and is actually back-dated for widows and widowers, so any unused allowances from their deceased spouse can now be utilised without the need for a deed of variation. This will have effect no matter what the date of death of the first spouse.

You may have been advised in the past to put discretionary nil rate band wills in place to utilise the first nil rate band. While it will no longer be necessary to have a will structured like this, it may not need updating, as long as it was drafted flexibly and the executors could decide whether to utilise the nil rate band or not. We would recommend that all wills are reviewed in light of the changes, and would always suggest that they are revisited every five years or so in any case.

Non-domiciled individuals

Non-domiciled individuals have benefited from generous tax treatment in the past. Where income and capital gains have not been remitted to the UK, they have not had to pay UK tax. However new rules will have effect from 6 April 2008, and affect non-domiciliaries once they have been resident in the UK for seven years. If they wish to retain the remittance basis they will be subject to an additional tax charge of £30,000 a year. Alternatively they will be subject to UK tax on their worldwide income and capital gains. From 6 April 2008, non-domiciled individuals who wish to benefit from the remittance basis (even those within the initial seven year period) will not be entitled to a personal allowance, which also includes married couples allowance and blind person's allowance (subject to a £1,000 de minimis of unremitted foreign income).

Further changes involve the closing of loopholes utilised by individuals to bring foreign income and capital gains into the UK tax free, including the frequently used "ceased source" rule. Specific rules preventing the remittance basis being utilised on income from the Republic of Ireland are being removed. There will also be a consultation process to consider whether those who have been resident in the UK for more than ten years should make a greater contribution.



Residence

Under current legislation, when deciding whether an individual is resident in the UK, days of arrival and departure in the UK are ignored. From 6 April 2008 these days of arrival and departure will now be included as days of presence in the UK for residence test purposes.

This rule is brought in to counteract those individuals claiming non-residence who live outside the UK, but commute to and work in the UK, for instance travelling in on the Monday, and leaving on the Thursday.

Stamp Duty and Stamp Duty Land Tax

Minor changes in Stamp Duty have been made to reduce the administrative burden for small value transactions. Any transaction that results in a Stamp Duty charge of £5 or less will now be exempt, and will not have to be presented for stamping. This will result in purchases of shares of less than £1,000 being exempt from Stamp Duty.

Land Transactions where the consideration exceeded £1,000 had to be declared, even though no Stamp Duty Land Tax was payable. This limit has now risen to £40,000.

This guide is intended for general guidance only at a time when details are still emerging. Please talk to a professional adviser before taking any action that may affect your business.

Errors and omissions excepted.