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Changes to Capital Gains Tax

Over the next two years, the tax-free allowance for capital gains is being reduced by over 75%. In this article we discuss the rules on capital gains tax and five ways you can reduce your potential tax bill.

What is capital gains tax?

Capital gains tax (CGT) is charged on gains made when an asset is sold or transferred.

The most common example is selling an investment, such as a share, but tax is also liable if you transferred an investment, property or, business asset.

Capital gains within an ISA or SIPP are sheltered from CGT along with profits made on your main private residence and most personal items worth £6,000 or less are exempt. Individuals get a tax-free allowance for gains each tax year, but above this CGT is liable.

What is changing?

The main news is a huge cut to the tax-free allowance, officially known as the Annual Exempt Amount (AEA).

The AEA cannot be carried forward if you do not use the full amount in a year. For individuals and personal representatives (of an estate) the AEA is currently £12,300. Chancellor Jeremy Hunt confirmed that the new AEA will reduce from £12,300 to £6,000 on 6th April 2023. It will then be further cut from £6,000 to £3,000 on 6th April 2024. The actual rates of tax will remain unchanged and the ability to use losses to offset gains remains.

If you are acting as an executor or personal representative for a deceased person's estate, you may get the full annual exempt amount during the administration period. The administration period is usually the time it takes to settle the deceased person's affairs and apply for grant of probate (or confirmation in Scotland).

You are entitled to the annual exempt amount for the tax year in which the death occurred and the following two tax years. After that there is no tax-free allowance against gains during the administration period.

Rates of CGT

To work out the rate of tax on any gains, you will need to know your income for the year. It also depends on the type of investment you have sold.

Any part of the gain that still sits within the basic rate band for income tax when added to your taxable income will be taxed 10% (or 18% on residential property). Gains above the basic rate band will be taxed at 20% (or 28% on residential property). The calculations, gains, and any tax due will need to be reported on your annual self-assessment tax return.

Crucially the rules say that residential property gains must be reported to HMRC within 60 days of completion, rather than on an annual tax return.

So, what action can investors take to reduce the tax they might pay?

1. Use the annual exemption (AEA)

The AEA will remain at £12,300 for the rest of the 2022/23 tax year, before reducing to £6,000 on 6th April 2023 and to £3,000 from 6th April 2024. You cannot carry forward any part of the AEA you do not use so if you have a large potential gain, it might be worth making the most of this year's higher AEA before it starts to reduce.

2. Making use of losses

You might be able to minimise your CGT liability by using losses to reduce your gain. Gains and losses realised in the same tax year must be offset against each other, which can reduce the amount of gain that is subject to tax. Unused losses from previous years can be brought forward, provided they are reported to HMRC within four years from the end of the tax year in which the asset was disposed of.

3. Transfer assets to your spouse or civil partner

For this to be effective, the transfer of ownership must represent a genuine gift from one to the other. These transfers are exempt from CGT on a 'no gain, no loss' basis. There is no cap on the value. This is particularly useful where you are planning to sell an investment and your spouse or civil partner has not used their own AEA and may benefit from a lower tax band.

When you transfer investments to a spouse or civil partner, make sure you keep a note of the original cost to you as this also transfers across to them with the investment and will be needed when they come to sell it themselves.

4. Make the most of ISA and SIPP tax free wrappers

Gains on investments held in a Stocks and Shares ISA and SIPPs are sheltered from CGT. The current ISA allowance is £20,000 per tax year (across all types of ISAs combined) per person and this will become even more valuable as the reduction in the AEA starts to bite.

The investments held within your SIPP receive the same tax-free treatment but have a variable annual allowance dependent upon the members income.

5. Gift hold-over relief

When assets are given away, they are normally treated as a disposal for CGT.

There are two circumstances where hold-over relief may be available.

1. the transfer of business assets (including unlisted shares),
2. transfers both into and out of relevant property trusts.

Claiming holdover relief means that you won't pay Capital Gains Tax on the full market value of the asset when it is given away or sold below market value, instead the liability will be "held over" until the next sale by the recipient.

When a director closes or sells their business, they will be required to pay Capital Gains Tax on any profits they have made. However, holdover relief allows a director to avoid paying Capital Gains Tax in certain circumstances. In effect, holdover relief passes the tax obligation onto the recipient of the gift.
