

Will you be a winner or a loser in Alistair Darling's new Capital Gains Tax world?

Capital Gains Tax Changes – Why you need to consider taking some action now.

When Gordon Brown introduced taper relief ten years ago he clearly stated his rationale was to reward small businesses, entrepreneurs and those who held assets long term. The older indexation allowance which effectively eliminated that element of the gain due to inflation was retained up to that date, and he introduced a tapering reduction for gains, up to 75% for business assets (if held for two years) and up to 40% for non business assets (if held for up to ten years). Now all is to change, unless the intense lobbying by the CBI and others is successful, in which case the rules will be uncertain for some time.

From 6 April 2008 taper relief will disappear and so will indexation allowance. Tapered Gains will no longer be charged at 20% and 40% but at a flat rate of 18%. At first sight this looks like good news until you actually do the calculations.

There will be winners but there will be some surprising losers.

Small business owners

There are many small business owners holding assets on which they expected to pay an effective maximum Capital Gains Tax rate of 10%. Now this will be 18% flat rate. This will not be just an increase of 80% but may be as much as 235% or even more. (see example 2)

Example 1

Mr Brown has been in business for many years, which he has built up from scratch. He plans to sell the business to Mr Green for £400,000. As a higher rate tax payer he is expecting to pay a maximum Capital Gains bill of £40,000 because he has been told the effective rate is only 10%.

If he sells before 5 April 2008 his tax liability will be £36,320.

If he sells after 5 April 2008 his tax liability will be £70,344 (nearly 94% more).

Long term owners of small businesses

The loss of indexation allowance can have even more severe consequences:

Example 2

Mr Brown bought a business in March 1982 for £50,000 and is now to sell it for £400,000. If he sells before 5 April 2008, taking advantage of both indexation allowance and business asset taper relief, his Capital Gains Tax bill will be £26,120. If he sells it after April 2008 his tax liability will be a staggering £61,344. (235% more)

Long term owners of non business assets

For many owners of non business assets it is expected that Capital Gains tax will be lower for disposals after 5 April 2008 than before April 2008.

Example 3

John owns a buy to let property which he bought on 16 March 1998 for £100,000. He has just sold it for £200,000. As a higher rate tax payer his Capital Gains Tax liability will be £20,320. Had he waited until after 5 April 2008 his tax liability would only have been £16,344, a saving of £3,976. (just 20% saving)

But this is not always the case

Example 4

John owns a buy to let property with Janet, his sister. They both earn £15,000 per annum. They have just sold the property for £200,000 having acquired it for £100,000 on 16 March 1998. Their capital gain after taper amounts to £20,800 each on which they will each pay just £4,160 each. They are basic rate taxpayers and their gain falls into the lower rate band, so they only pay capital gains tax at 20%. However if they sell after 6 April 2008 their Capital Gains Tax liability will be £7,344 each.

In deciding whether you are a winner or a loser depends on your income, the size of your potential gain, the length of time the asset has been owned, whether there is indexation allowance, and the type of taper relief available. **Advice must be sought for any transaction you are considering.**

What you need to do now

Whether you are a higher rate or basic rate taxpayer, **if you are planning to sell** your business, a property or any other asset and expect a Capital Gain in the next twelve months you must take advice to ensure the timing is correct.

For those business owners who are **approaching retirement or are considering the disposal of all or part of the business in the near future** you should take advice now to see whether there is a way to take advantage of the 10% rate before it is lost.

For those business owners who have **large potential gains**, you may wish to re-consider your business exit strategy.

Have you sold your business recently and are now holding **loan notes**? You will need to consider revised options.

Budget Day 2008

This is the situation as at 9 October. There is no draft legislation at this stage so we need to wait until the budget for the detail, but we also need to be realistic because businesses and properties cannot be sold overnight. There are indications that the CBI, the Trade Unions and other business institutions will be lobbying Parliament over the unfairness of these proposals so there may yet be amendments in the final legislation.

In such a fluid situation waiting until April 2008 may be too late. It is important that you discuss your situation with us. Please contact either the partner acting for you or one of our tax team:

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