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Newsletter: March 2022

Mitigating Capital Gains Tax

Capital Gains Tax was introduced by James Callaghan in 1965 and later reformed by the Labour government in 2008. According to the Office for Budget Responsibility, in the 2019-20 tax year, CGT raised £9.8 billion.

Commentators suggest that total receipts from CGT could rise sharply in the current tax year, off the back of a bump in buy-to-let investors and business owners selling off assets for fear of potential tax rises.

After much speculation, the rate of CGT was not changed in 2021, but this does not mean it will not be changed in due course. It seems that more and more people are having to pay CGT.

This may seem surprising, given the wide range of tax-saving opportunities available, but CGT is a complicated tax, and it can be difficult to calculate gains and losses accurately. Many individuals could end up paying CGT unnecessarily or, worse still, face fines due to incorrect disclosure.

Failing to manage capital gains effectively can also create a bigger potential Inheritance Tax liability on our estate, on which assets will be taxed at 40%, so forward planning is essential.
In this Newsletter, we provide answers to some of the most frequently asked questions about CGT.

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What is Capital Gains Tax?

CGT is a tax on the profit when we sell something that has increased in value. CGT applies only to the gain we make, not the amount of money we receive for the asset.

Gains from almost any kind of personal possessions can be liable to CGT, including shares that are not held in a pension or ISA wrapper, buy-to-let properties, jewellery or paintings, and coins and stamps.

It is important to remember that we do not have to pay CGT if all our gains in one tax year are below our tax-free exemption.

How much can I gain before paying CGT?

There is an annual exemption from CGT, which is currently £12,300 for individuals. This tax-free amount has been frozen until 2026 so, with increasing asset prices, more of us are almost bound to have to pay more CGT.

Any gains realised within the annual exemption incur no tax. So, to give a simple example, if we had bought an asset some time ago for £12,300 and we were now selling it for £24,600, our gain would be £12,300 and would, therefore be CGT free providing, of course, we had no other gains in that tax year.

This exemption cannot be carried forward into the next tax year, so it is often advisable to use the CGT exemption each year in order to reduce the risk of incurring a significant CGT bill in the future. This can be tricky when investing in illiquid assets, such as property.

What rate will I pay?

The rate of CGT that we will pay will depend on our other income. If we are a basic rate taxpayer and the gains on any assets sold are within our Income Tax basic rate band, we will pay 10% for most assets and 18% on residential property that is not our main home. If our combined income and gains are above the higher rate threshold, we will pay 20% for most assets and 28% on residential property.

Which assets are free from CGT?

We do not pay any CGT on assets held in a pension or a stocks and shares ISA. Nor do we have to pay CGT if we sell our car or our main residence.

How can I mitigate CGT?

Here are some simple ways by which we can mitigate CGT.

- **Use our annual exemption**

As mentioned above, we can realise a gain of up to £12,300 each year without paying CGT. Therefore, if we have liquid investments which are pregnant with capital gains, we could realise a sufficient amount in order to limit the capital gain to £12,300, thereby enabling us to disinvest without creating any tax liability.

- **Invest in an ISA/Bed & ISA**

Gains made on investments held within a stocks and shares ISA are exempt from CGT, so it makes sense, particularly for higher-rate taxpayers, to use the ISA allowance each year. In the 2021/22 tax year, we can invest up to £20,000 in an ISA. For married couples and civil partners, the ISA allowance effectively doubles to £40,000.

There is also a tactic called 'Bed & ISA', which involves selling assets to realise a capital gain (as described in the first bullet point above) and then immediately buying back the same assets inside an ISA. This enables all future gains on the asset to be CGT free.

- **Make use of losses**

We might be able to minimise our CGT liability by using losses to reduce our 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.

- **Transfer assets to your spouse or civil partner**

Transfers between spouses and civil partners are exempt from CGT, which means assets can be transferred from one partner to the other to use each person's annual CGT exemption. This effectively doubles the CGT exemption for married couples and civil partners to £24,600.

- **Contribute to a pension**

Making a pension contribution could help us save CGT because it effectively increases the upper limit of our income tax band. If, for example, we made a gross pension contribution of £10,000, the point at which higher-rate tax becomes payable would rise from £50,270 to £60,270 (2021/22 tax year). If our capital gain plus other taxable income fell within this extended basic-rate income tax band, CGT would be payable at 10% instead of 20%.

There are other, more complex ways of mitigating CGT such as gifting to charity, investing in an Enterprise Investment Scheme (EIS) or claiming 'hold over' relief. If you would like to know anything further, please contact us.

For now, we hope this has been a useful summary of some of the key considerations when looking to mitigate CGT.

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Market data

Market	2021	Current situation	Comments
Interest Rates (BOE base rate)	Increased from 0.1% to 0.25% in December	0.5% at 28/02/22	The official bank rate is 0.5%.
House Prices (Nationwide)	House prices increased by 10.4%	House prices up 1.7% at 28/02/22	Annual house price growth up 12.6%.
UK Share Prices (FTSE 100)	Closed at 7384.5. An annual rise of 924 points	7458.25 at the close on 28/02/22	The FTSE 100 rose by 2.94 points in February