CAPITAL GAINS TAX

We outline the rules that apply when you sell or give away an asset – and how you can reduce any tax liability

Many people own assets, such as shares, unit trusts and second properties, that can appreciate in value while they own them. These increases in value may be taxed through capital gains tax (CGT) when you sell or give assets away.

HOW MUCH TAX?

In general, only gains or losses since 31 March 1982 are taken into account, and some gains (see right) are tax-free. If the gain is not tax-free, the tax is based on the increase in value of the asset during the time you owned it. The tax you pay is calculated by taking the final value of the asset when you disposed of it and subtracting the initial value when you acquired it, along with any allowable expenses. The first slice of capital gains (£8,200 in the 2004-2005 tax year, £8,500 in the 2005-2006 tax year) is also free of tax.

Your taxable gains are treated as the final slice of your income. The rate of tax you pay depends on which tax band your taxable gains fall into after all other income has been taken into account. So income from your job, business or pension plus income from property, savings, dividends and other investments is applied against the tax bands before any capital gains.

For 2004-2005, if your total taxable income and gains are below £2,020, you pay 10 per cent tax; on gains that fall in the basic-rate tax band (£2,021 to £31,400), you pay 20 per cent tax; and on gains that fall into the higher-rate band (over £31,400), you pay 40 per cent. For 2005-2006, the starting-rate band increases to £2,090, and the higher-rate band to £32,400.

Assets owned on 31 March 1982

Where you dispose of an asset that you held on 31 March 1982, you may be able to use the market value on 31 March 1982 to work out the gain (or loss). If you do, you must ignore all expenses incurred before that date. For further information, see Inland Revenue helpsheet IR280 *Rebasing assets held at 31 March 1982*.

LOSSES

You must offset any loss you make on the sale or transfer of an asset against any gains you make in the same year. If, after using your current year losses, you still have gains above the tax-free slice, you must use any losses made in previous years to reduce your gains to the level of the tax-free amount. You can't offset losses on assets or transfers that are exempt from capital gains tax, such as Peps or Isas. The exception is losses on Enterprise Investment Scheme shares.

Unused losses

You can carry forward indefinitely any losses you haven't used against gains, irrespective of when you made the loss. You must tell the Revenue of your losses if you intend to carry them forward, either on the capital gains tax pages in your tax return if you get one, or by letter if you don't. You have just under six years from the end of the tax year to tell the Revenue (so until 31 January 2011 for losses made in 2004-2005). There is no time limit for notifying the Revenue about losses made before 6 April 1996 but you do need records to back up your calculations.

TAX-FREE GAINS

The main assets and transactions that are free of CGT, subject to certain conditions, are:

- your only or main home (but see 'CGT on your home', p55)
- private motor cars
- betting, lottery or pools winnings
- British government stocks (gilts), most corporate and local authority bonds and building society permanent interest-bearing shares (PIBS)
- 'cashbacks' when you buy something
- gifts to charities and gifts of National Heritage property
- National Savings & Investments products, Peps and Isas, and pensions
- shares in a Venture Capital Trust and shares held through an Enterprise Investment Scheme (or earlier Business Enterprise Scheme)
- shares held in an approved share incentive plan

- proceeds from life insurance policies, unless they're bought second-hand
- personal injury compensation
- personal possessions with a useful life of 50 years or less from the date you acquired them. For possessions with a longer life, see 'Chattels', p55.

REDUCING YOUR BILL

Just because you've made a capital gain doesn't mean you'll have to pay CGT. Your potential bill may be reduced by taper relief, and, for assets acquired before 5 April 1998, by indexation allowance as well.

Indexation allowance

Indexation allowance applies to assets acquired before 1 April 1998. It means that you are not taxed on gains made because of inflation between the date of acquisition (or March 1982 if later) and April 1998. Your initial value and allowable expenses are linked to – and increased in line with – the retail price index (RPI). As a result your taxable gain is reduced or eliminated. But you can't use indexation to create or increase a loss.

Taper relief

Taper relief reduces the chargeable gain depending upon the length of the time you've owned the asset after 5 April 1998. Within limits, the longer you hold the asset, the smaller the proportion of any gain you pay tax on (see 'How taper relief works', right). You get more taper relief on business assets (see overleaf for what counts as a business asset). If an asset has been both a business and non-business asset, the gain is split between the two taper relief rates. See Inland Revenue helpsheet IR279 *Taper relief*.

You must own a non-business asset for at least three whole years, and a business asset for at least one whole year, before taper relief reduces your

HOW TAPER RELIEF WORKS

If you bought a non-business asset (shares, say) in 1993 that you sold in July 2004 for a profit of £1,404 (after deducting indexation allowance up to April 1998 and any allowable losses), this is how taper relief would apply.

Your net gain	£1,404
Complete number of years held after 5 April 1998 (including extra year as asset was held before 17 March 1998)	7 years
Percentage of gain chargeable for non-business assets (with qualifying period of seven years)	75%
Net chargeable gain is 75 per cent of £1,404	£1,053

If you'd used up your capital gains tax-free slice, you'd pay £105.30 capital gains tax on this gain if the gain fell into the starting-rate band; £210.60 if in the basic-rate band; and £421.20 if it fell into the higher-rate band. This is equivalent to paying capital gains tax at 15 per cent for basic-rate taxpayers (30 per cent for higher-rate taxpayers) on the original gain of £1,404.

	Gains on business assets		Gains on non-business assets	
Complete years after 5 April 1998 that asset was held	Percentage of the gain that is chargeable – the taper (%)	Equivalent CGT rate for higher-rate/basic-rate taxpayers 40/20% of the taper	Percentage of the gain that is chargeable – the taper (%)	Equivalent CGT rate for higher-rate/basic-rate taxpayers 40/20% of the taper
0	100	40/20	100	40/20
1	50	20/10	100	40/20
2	25	10/5	100	40/20
3	25	10/5	95	38/19
4	25	10/5	90	36/18
5	25	10/5	85	34/17
6	25	10/5	80	32/16
7	25	10/5	75	30/15
8	25	10/5	70	28/14
9	25	10/5	65	26/13
10	25	10/5	60	24/12

INDEXATION FACTS

Imagine you paid £1,000 for a painting in May 1985 and sold it in May 2001. The indexed cost is £1,000 x 1.708 (factor for May 1985), which gives £1,708. You are liable to tax only on the difference between the selling price and £1,708.

Month	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Jan		1.968	1.872	1.783	1.689	1.626	1.574	1.465	1.361	1.249	1.199	1.179	1.151	1.114	1.083	1.053	1.019
Feb		1.960	1.865	1.769	1.683	1.620	1.568	1.454	1.353	1.242	1.193	1.171	1.144	1.107	1.078	1.049	1.014
Mar	2.047	1.956	1.859	1.752	1.681	1.616	1.562	1.448	1.339	1.237	1.189	1.167	1.141	1.102	1.073	1.046	1.011
Apr	2.006	1.929	1.834	1.716	1.665	1.597	1.537	1.423	1.300	1.222	1.171	1.156	1.128	1.091	1.066	1.040	
May	1.992	1.921	1.828	1.708	1.662	1.596	1.531	1.414	1.288	1.218	1.167	1.152	1.124	1.087	1.063	1.036	
June	1.987	1.917	1.823	1.704	1.663	1.596	1.525	1.409	1.283	1.213	1.167	1.153	1.124	1.085	1.063	1.032	
July	1.986	1.906	1.825	1.707	1.667	1.597	1.524	1.408	1.282	1.215	1.171	1.156	1.129	1.091	1.067	1.032	
Aug	1.985	1.898	1.808	1.703	1.662	1.593	1.507	1.404	1.269	1.213	1.171	1.151	1.124	1.085	1.062	1.026	
Sept	1.987	1.889	1.804	1.704	1.654	1.588	1.500	1.395	1.258	1.208	1.166	1.146	1.121	1.080	1.057	1.021	
Oct	1.977	1.883	1.793	1.701	1.652	1.580	1.485	1.384	1.248	1.204	1.162	1.147	1.120	1.085	1.057	1.019	
Nov	1.967	1.876	1.788	1.695	1.638	1.573	1.478	1.372	1.251	1.199	1.164	1.148	1.119	1.085	1.057	1.019	
Dec	1.971	1.871	1.789	1.693	1.632	1.574	1.474	1.369	1.252	1.198	1.168	1.146	1.114	1.079	1.053	1.016	

GLOSSARY

Allowable expense
Some costs of acquiring or disposing of assets (such as commission, legal fees, stamp duty and advertising) can be deducted from your gains.

Final value
The asset's sale price or market value at the time you dispose of it. If you sell for less than that market value, the final value is usually the market value.

Initial value
The price paid for an asset or its market value when you received it. For assets acquired before 31 March 1982, you have a choice of value.

Indexation
An allowance that stops you paying tax on increases in value due to inflation. It applies only to increases up to April 1998.

Taper relief
This reduces the gain liable to tax, depending on the number of years you own the asset after 5 April 1998.

WHICH? EXTRA

This year we've moved our capital gains calculator online – see www.which.co.uk.

The calculator is also available as a free factsheet. Phone 0845 307 4000 and ask for code TAXC05.

tax bill. However, non-business assets held before 17 March 1998 have an extra year added to the period of ownership. So non-business assets held before 17 March 1998, and disposed of in the 2004-2005 tax year, have seven years' qualifying ownership, and so only 75 per cent of the gain on these assets will be liable to tax.

Losses and taper relief

Any losses must be deducted from gains before you apply taper relief. However, you allocate losses to gains that qualify for the least amount of taper relief first. This ensures you make the most of your taper relief. Of course, taper relief applies only if the remaining gain is greater than the tax-free slice.

BUSINESS ASSETS

For the purpose of taper relief, a business asset is:

- an asset used for a trade carried on either by you or your qualifying company
- an asset owned by you as an employee or director of a trading business for use at work
- shares or securities you own in a qualifying company.

For periods of ownership from 6 April 2000, a company counts as a 'qualifying' company if it is:

- an unlisted trading company, or
- a listed trading company in which you can exercise at least 5 per cent of the voting rights, or
- a listed trading company which employs you, or
- a non-trading company which employs you, provided you do not have an interest of more than 10 per cent of the company.

From 6 April 2004, an asset owned by you but used by someone else in their trade or profession will also be treated as a business asset.

For periods of ownership before 6 April 2000, the definition was more restrictive. If this applies to you, see Inland Revenue helpsheet IR279 *Taper relief*.

CGT ON SHARES

Unless held in a tax-exempt scheme such as an Isa, gains on shares and unit trusts are liable to CGT in the normal way, but some special rules apply. If you acquire shares of the same type in the same company (or units in the same unit trust or Oeic), but at different times, they look identical.

But to work out the initial value and taper relief, the Revenue assumes you dispose of your shares in a strict order. See Inland Revenue helpsheet IR284 *Shares and capital gains tax* for more.

Scrip dividends

Scrip dividends are dividends paid as shares rather than cash. Scrip dividends received after 5 April 1998 are treated as a new acquisition of shares at the dividend date. For how to treat earlier dividends, see Revenue helpsheet IR285 *Share reorganisations and takeovers*. The dividend voucher usually shows the shares' allowable cost.

Rights and bonus issues

Except when working out any indexation allowance, extra shares you receive under rights or bonus issue count as belonging to the same holding as the original shares to which they relate. So they have the same acquisition date and value as the original shares and anything paid for the new shares is added to the cost of the original holding. But for working out any indexation allowance (that is for shares issued before 6 April 1998), anything paid is an allowable expense incurred on the date you made the payment. For more information, see Inland Revenue helpsheet IR285 *Share reorganisations and takeovers*.

The company issuing the shares usually gives details of how they are treated for tax in the circular or prospectus.

Windfall shares

For government privatisation shares, indexation runs from the date you acquired the shares, even if you paid by instalments. Any loyalty bonus shares count as if you bought them at their market value on the date of issue.

Free shares arising from a building society demutualisation are treated as acquired at 'nil cost' – you have no initial value to deduct from your gain, so indexation allowance does not apply (although taper relief does). There may also be

Some shares qualify for favourable tax treatment

some tax to pay on a cash windfall (from a share account, not a deposit account). Where the account that entitled you to the cash or shares was a joint account, the gain is normally split.

The tax treatment of free shares from other demutualisations – for example, from a life insurance company – depends on the exact terms of the deal.

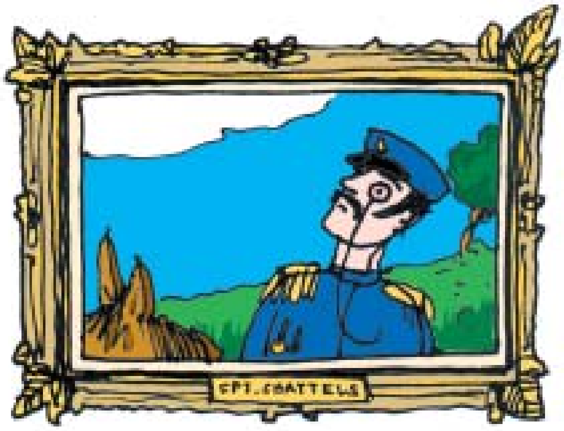
Takeovers and mergers

Exchanging shares for new shares due to a takeover or merger won't normally count as a disposal. The new shares simply replace the old. If you exchange old shares for new shares and cash, you're assumed to have disposed of a proportion of your old shares (the percentage of the exchange represented by cash), unless the cash received is less than £3,000 or not more than 5 per cent of the value of the shares in the original company. In this case, the allowable cost of your original shares is reduced by the amount of cash.

Incentives to invest

Some shares qualify for favourable tax treatment.

- There is no CGT if you cash in a Pep, Isa,



Venture Capital Trust and some shares in an Enterprise Investment Scheme.

■ You can put off paying some or all of CGT on the disposal of any asset if you reinvest in an Enterprise Investment Scheme. You can no longer defer CGT by investing in a Venture Capital Trust.

■ If you have an asset which has become 'of negligible value', you may be able to claim a loss even if you don't dispose of it. See Inland Revenue helpsheet IR286 *Negligible value claims for shares* for more information.

■ Shares in an unlisted trading company, or a company for which you work, may qualify for increased taper relief as a 'business asset'.

CHATTELS

A chattel is a tangible, moveable thing that you own, such as a painting or antique furniture. Cars are exempt from CGT, as is sterling currency and foreign currency for your own use abroad, and chattels with a useful life of 50 years or less at the time you acquired them.

CGT applies to other chattels only if the disposal proceeds are more than £6,000. Where the proceeds exceed £6,000, the chargeable gain cannot exceed 5/3rds of the amount above £6,000. Say you sold a painting for £7,500; the maximum chargeable gain would be £2,500 (5/3 of £1,500). These rules apply to a disposal of a single chattel. If you sell a set (of chairs, for example), the £6,000 limit applies to the set, not the individual item. For more advice, see Inland Revenue helpsheet IR293 *Chattels and CGT*.

CGT ON YOUR HOME

If you've lived in the whole of your only or main home since you acquired it, private residence relief means that CGT won't usually apply when you come to sell unless:

■ you converted your home into self-contained flats and sold them, or built a second home in your garden and then sold it. However, whether or not CGT applies even then depends on individual circumstances, or

■ you use part of your home exclusively for business, or you let part of it, or

■ you were away from your home for more than three years in total. Absences related to your job, a divorce or delay in taking up residence can result in further concessions

■ the home is one of a series that you bought to make money

■ you were away for less than three years but didn't use the home as your main home at some stage before and after. If you are absent in the last three years, this is usually exempt from CGT, as are some first-year and work-related absences.

You may not get full exemption for your garden if, including the house, it's over half a hectare (1.2 acres). See Inland Revenue helpsheet IR283 *Private residence relief*. If you sell part of your garden as a separate plot, you'll probably have to pay CGT on any gains you make.

Letting your home

You don't lose any tax relief if you have a lodger who shares your living rooms and eats with you. Otherwise, part of any gain when you sell property you let out may be liable for tax. See Inland Revenue helpsheet IR283 *Private residence relief* for more details. Property you let out doesn't qualify as a business asset for taper relief unless it counts as furnished holiday lettings or is let to a qualifying company, sole trader or partnership and used for a trade.
See 'Income from property', p32.

More than one home

If you own and use more than one home, you can choose which one qualifies for private residence relief. It makes sense to choose the one on which you think you'll make the largest gain – this doesn't have to be the one where you live most of the time. You must notify your tax office of your choice within two years of owning and living in the two homes. You can change your choice, and specify the date any change should take effect from, as long as this isn't more than two years before the date you told your tax office of the change. If you don't make the choice, the Revenue will decide based on the facts of the case. ■

TAX RETURN

If you receive a tax return, you'll have to complete the capital gains pages (SA108) if:

■ chargeable assets you disposed of during the 2004-2005 tax year were worth £32,800 or more, or

■ you deduct losses from your gains, but your gains before losses and taper relief are £8,200 or more, or

■ you don't deduct losses, but your gains after taper relief are £8,200 or more, or

■ you have a loss to claim or you intend to notify the Revenue about losses to be carried forward.

The capital gains pages aren't straightforward so read the Revenue's notes (SA108 (Notes)) carefully. If you don't receive a tax return, you have to notify the Inland Revenue only if you have capital gains on which tax is due.

MORE HELP

Inland Revenue helpsheets and booklets

■ CGT1 Capital gains tax: an introduction
■ IR87 Letting and your home
■ IR279 Taper relief
■ IR280 Rebasing – assets held at 31 March 1982
■ IR283 Private residence relief
■ IR284 Shares and capital gains tax
■ IR285 Share reorganisations and takeovers
■ IR286 Negligible value claims for shares
■ IR287 Employee share schemes
■ IR290 Business asset roll-over relief
■ IR293 Chattels and CGT
■ IR297 Enterprise Investment Scheme and CGT
■ IR298 Venture Capital Trusts and CGT