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CAPITAL GAINS TAX ISSUES

2008 Reforms

UK Capital Gains Tax (CGT) was reformed significantly in 2008. The most significant change was the reduction of the general CGT rate from 40% to 18%. At the same time a range of exemptions and reliefs which used to apply, were removed. Many of these exemptions had reduced the effective rate of tax to as low as 10%.

The reduction in the UK CGT rate caused controversy because in certain cases, particularly those related to business and enterprise, the abolition of the old taper relief caused the rate to increase from 1o% to 18%. For this reason, a special 10% rate was introduced to cover same narrow categories of cases.

An individual who is resident or ordinarily resident and domiciled (i.e. permanent home) in the UK is subject to CGT on his worldwide income. A resident or ordinarily resident but non domiciled UK individual was formerly subject to CGT only in respect of non-UK gains to the extent they were remitted into the UK. This provision was changed in 2008. A non domiciled UK resident individual can elect for this special treatment, but he must pay an annual £30,000 charge to do so.

Formerly taper relief was available to reduce the capital gain by up to 75% where assets had been owned for a number of years. This relief was particularly generous for business assets. With the introduction of the 18% rate taper relief has been removed.

Formerly, relief was allowed against inflation on the original purchase price and any capital improvements. However, the relief has been removed for disposals by individuals or trustees after 5th April 2008.

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CGT / Income Tax borderline

Speculative short term disposals, particularly of land and investment properties, may be deemed subject to income tax. Where an asset is acquired with a view to being resold in s short term HMRC may deem the transaction to be a trade which is accordingly subject to income tax.

There may be deemed to be a trade where one or more of the following apply:

- the asset is acquired with a view to being resold in the short term
- a large part of the purchase price is financed by short term borrowings
- the seller has a background of similar transactions or special expertise that assists in achieving a profit

Income tax liability for the sale (in the case of a trade) applies to both UK residents and non residents. Therefore where transactions are deemed "income" transactions, a non UK resident may be subject to income tax. This is a particular risk for builders, developers or individuals who enter land transactions, particularly a number of transactions.

Gifts, options and conditional sales

CGT will apply to an outright sale but also to other transactions such as a conditional sale or the grant of an option. It will also be applied to a gift and to a situation where sums are received by way of compensation or under the proceeds of an insurance company. It also applies to assets which have been destroyed or have become of negligible value. The compulsory acquisition of an asset will be a disposal for CGT purposes.

A gift is a disposal for CGT purposes at market value. UK Inheritance tax may also rise. There are reliefs which postpone CGT liability where a gift involves business property or where there is a transfer subject to inheritance Tax purposes such as a gift to a trust.

Miscellaneous

When a person inherits an asset, he is generally deemed to take it at the market value of the date of death of the person from whom he has inherited. This means that when a person dies, any latent capital gains in assets they own is removed from the CGT charge. In effect Inheritance Tax is the only relevant tax on death.

Relief for a CGT loss is not allowed on the disposal of an asset which has already attracted capital allowances.

There is special relief for takeovers and mergers where a company issues shares or other securities or takes at least 25% stake in a company. The shareholders who accept the shares will not be treated as disposing of their shares subject to certain conditions. In effect their new shares will be in addition to their older shares. If they receive a mixture of cash and shares then there will be a part disposal in relation to the cash element.

Where a UK resident disposes of non UK property the proceeds and acquisition costs must be recalculated in sterling. The exchange rate at the time of disposal is taken in respect of the sale price and acquisition cost.

Where CGT is payable (by an UK resident) and foreign tax is also payable, Double Taxation relief is generally also available.
