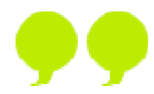
Article topic: Tax Planning

February 2010

Where now for Capital Gains Tax rates?



With Capital Gains Tax rates likely to rise, Paul Morris, Director of Tax Planning, advises business owners to start planning now.

Most commentators agree it is only a matter of time before the Government is forced to tackle the massive gap between the new 50p top rate of income tax and the 18% rate of Capital Gains Tax (CGT).

In a surprise move, CGT rates were slashed from 40% to 18% in April 2008 – the first change since 1988. At the same time, taper relief for business owners was abolished and replaced by a less generous Entrepreneurs' Relief, giving a 10% effective tax rate on only £1m of business gains.

However, since the measures were first announced in 2007, the UK's economic position has deteriorated significantly. It is now widely accepted that faced with an escalating budget deficit, whoever is in power after the election will need to demonstrate economic prudence.

With forecasted revenues from CGT in 2009-10 amounting to only £2.4bn, CGT is not a big revenue earner compared to the £229bn generated from income tax and NIC. However, with income tax and NIC rates on the rise, increasing CGT will act as an 'anti-avoidance' measure to deter wealthier individuals from trying to convert income to capital.

Key questions being asked by our clients right now include:

- When might rates increase?
- How far could they go and will the current 10% rate be affected?
- What measures can be taken to protect against it?

Timing of any rate increase?

Unfortunately, we don't have a crystal ball. Although recent changes in headline tax rates have typically been announced in the Pre-Budget Report (PBR), an announcement on CGT was strangely absent in last year's PBR. So can we expect a rate increase to be deferred – at least until after the election, if not beyond?

One clue may lie in the fact that following the announcement to abolish taper relief in 2007, CGT receipts swelled by over 50% in one year to over £7.8bn as people rushed to sell assets ahead of the change. Pre-announcement of the rules also led to harsh exchanges with business leaders, resulting in the provisions having to be watered down. It is, therefore, possible that the Chancellor may not be so generous this time around, and a rise in CGT rates in the March 2010 Budget cannot be ruled out.

CGT rate & Entrepreneurs' Relief?

The current headline rate of 18% is significantly below the planned 50% income tax rate, and also below the lowest effective rate of income tax currently payable by higher-rate taxpayers of 25% on dividend income (36% from April). Therefore, alignment of CGT rates with the 25% dividend rate would be an obvious first staging-post, although looking back historically, it is perfectly feasible that a rate hike could go further.

Aside from the headline rate of CGT, it is possible that the Entrepreneurs' Relief allowance may not remain unscathed. In particular, the 10% rate arising from this relief is not a 10% rate as such, as it is calculated as a fraction of the main CGT rate. So, if the headline rate rises, the Entrepreneurs' rate will also increase by default – if it is not abolished all together.

What can you do?

For those concerned by the prospect of a CGT rate hike, time is of the essence and it is important to consider planning measures now to take advantage of a 10% or 18% rate. The same principles apply now as when the taper relief was abolished. The key is to crystallise some form of tax disposal, either by realising assets through sale, or engineering a disposal, possibly with a connected party.

- For quoted stocks and shares, some form of 'bed and breakfasting' may be the order of the day, but taxpayers will need to take care not to fall foul of the matching rules if shares are reacquired within 30 days.
- If an external sale is not feasible, transferring assets where substantial gains have been made to some form of 'family trust' may also be worth considering, possibly in conjunction with a strategy to mitigate inheritance tax. In addition, by using contracts that can be unwound, it is also possible to create a 'cake and eat it' scenario where the gain can be crystallised in 2009/10, but the obligation to pay the tax on 31 January 2011 is deferred until the asset is eventually sold – possibly up to five or 10 years down the line. The arrangement can be unwound at a later date if there is a change of mind.
- For business owners, some form of management buy-out (MBO) may be worth exploring. If structured correctly, this can allow the owner to realise the value of the business at current tax rates and extract cash from future profits as capital receipts. What's more, it is possible to remain involved with the business, albeit at a reduced level and without voting control.
- For unincorporated businesses and partnerships, incorporation and a sale of goodwill for a director's loan account may be a valid strategy, both from a CGT and income tax perspective.
- Commercial property owners should also remember that they can now sell property to their pension scheme. Apart from minimising CGT, this is a useful way to release cash from the fund whilst moving the property into a more tax efficient environment, where rents and gains are tax free.

In summary

If you are concerned about CGT, the key message is to speak to your Target consultant urgently ahead of any future announcements.

Your contacts	Bath	London	Midlands	Reading
	Paul Morris	Gavin Lenthall	Mark Tuckwell	Kevin Voller
	01225 486 300	020 7919 9100	01788 539 000	0118 958 1331

This document has been prepared as a general guide. It is not a substitute for professional advice. Neither Target Chartered Accountants or its employees accept any responsibility for loss or damage incurred as a result of acting or refraining from acting upon anything contained in or omitted from this document. Target Consulting Limited is registered to carry on audit work and regulated for a range of investment business activities by the Institute of Chartered Accountants in England and Wales. Target Financial Management is authorised & regulated by the Financial Services Authority. Tax advice is not regulated by the Financial Services Authority.