Capital gains tax – the fundamentals

Capital gains tax (CGT) is charged on capital gains which accrue to a 'person' on the 'disposal' of an asset.

CGT is usually assessed on the 'person' who disposed of the asset and that person is usually the beneficial owner of the asset. A person may be an individual, personal representative or trustee.

'Disposal' isn't expressly defined in capital gains tax legislation. Its meaning is broad in scope and includes sales, gifts and an exchange of assets. The principal legislation governing CGT is the Taxation of Chargeable Gains Act 1992 which consolidated the previous legislation.

This factsheet focuses on the CGT regime applying to the sale of listed shares and securities (for simplicity referred to as 'shares' throughout this factsheet) by UK resident and domiciled individuals. CGT applies to the disposal of worldwide assets held by such individuals.

Through case studies, we consider:

- How to calculate a gain matching the right costs to a sale of shares
- Losses and annual exemption
- Understand the tax rates that can apply to gains
- HMRC reporting obligations and payment due dates
- Married couples and civil partners
- Death

Calculating a capital gain or loss

The basic calculation is:

sales proceeds – acquisition costs = gain or loss

Sales proceeds

This is the amount received after the deduction of allowable costs incurred from selling the shares. Incidental costs of disposal are similar to incidental costs of acquisition.

Market value will be substituted for actual consideration if the disposal is not made at 'arms length', as will commonly be the case where shares have been gifted.

Acquisition costs

The phrases 'acquisition' and 'purchase' costs are used interchangeably and essentially have the same meaning.

Assets held on 31 March 1982 are automatically rebased to their market value at 31 March 1982. In other words, the market value of the particular shares held on this date will replace the actual costs incurred when a subsequent disposal takes place.

Allowable costs related to the acquisition of the shares will increase costs resulting in a lower gain or higher loss following a disposal.

Incidental costs of acquisition

Incidental costs of acquisition are defined in legislation with no other expenditure allowable. For incidental costs of acquisition to be allowed they must be wholly and exclusively incurred for the purposes of the acquisition. Such costs include stamp duty and certain professional fees. Professional fees are only allowable if directly referable to the cost of acquiring particular shares.

Previously, indexation was allowed as a measure of relief for inflation and had the effect of increasing costs in the CGT computation. However, for disposals made from 6 April 2008 onwards, indexation allowance isn't available to individuals.

Order of share identification

Shares of the same type are commonly bought at different times. If an individual decides to sell some of those shares, they will need to know how to identify the shares sold and which costs to use to work out the gain or loss. For example, if an individual has a holding of 10,000 National Grid ordinary shares, made up of shares bought at different times and at different prices, and they then sell 3,000 of these shares, we need to know how much cost is attributable to the shares sold. The capital gains rules allow us to do this.

The following rules apply to disposals from 6 April 2008. Disposals must be identified with acquisitions in the following order:

a. Shares acquired on the same day as the disposal

b. Shares acquired in the 30 days following the day of disposal*

c. Shares in the s104 pool 'the pooled share class'

d. If the above rules fail to exhaust the shares disposed of, the remaining shares are matched with later acquisitions taking the earliest acquisition first

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*It might seem odd to look at the cost of shares acquired after a sale but the 30 day rule was introduced to clamp down on a common tax planning tool known as 'bed and breakfasting' shares. This is where shares were sold and then almost immediately reacquired. Often this was to use up the individual's annual exemption while continuing to hold the same shares. This had the advantage that the shares were repurchased at a higher base cost reducing the potential future gain on a subsequent disposal.

Shares of the same class in the same company acquired at any time by a person will normally form part of what is known as the s104 holding (see c above). Shares that are identified with acquisitions on the same day or within 30 days after the disposal do not become part of this pool.

Let's consider some case studies to see how the rules work in practice.

Case study 1

William sells 500 ordinary shares in BT on 1 May 2017 receiving net sales proceeds of £2,000.

He bought the following shares in BT:

Date	Transaction	Holding	Cost (£)
1 April 2014	Buy	5,000	5,000
1 June 2016	Buy	500	1,000
		5,500	6,000

Taking the share identification rules, there are:

a. no acquisitions on the same day as the disposal

b. no shares acquired 30 days after the disposal

This means we look to (c), the s104 pool.

The gain on the sale of 500 shares is calculated as:

	£	£
Proceeds		2,000
Costs	500/5,500 x 6,000	(545)
Gain		1,455

The cost allowed against the sale of 500 shares is a fraction of the pool of the actual costs. The fraction is the number of shares sold divided by the total number of shares in the holding. The remaining cost (£6,000 - £545 = £5,455) in the holding to be used against future disposals is reduced accordingly. Note, if all the shares in the holding had been sold then the cost for our calculation would be the total pooled costs of £6,000.

Case study 2

Harry sells 300 ordinary shares in BG on 1 May 2017 receiving net sales proceeds of £1,500. He bought BG shares as follows:

Date	Transaction	Holding	Cost (£)	Proceeds (£)
1 June 2015	Buy	500	1,000	
1 May 2017	Sell	(300)		1,500
1 May 2017	Buy	100	500	
15 May 2017	Buy	100	400	

Looking at the share identification rules, there are:

a. Shares acquired on the same day as the disposal

b. Shares acquired in the 30 days following the disposal

c. Shares in the s104 pool 'the pooled share class'

The cost of the 100 shares bought on 1 May 2017 are matched to 100 of the 300 shares sold on the same day. This results in a nil gain as follows:

	£	£
Proceeds	100/300 x 1,500	500
Costs		(500)
Gain		NIL

The cost of the 100 shares bought on 15 May 2017 are matched to 100 of the 300 shares sold on 1 May 2017 (ie within 30 days of the sale). This results in a gain of £100.

	£	£
Proceeds	100/300 x 1,500	500
Costs		(400)
Gain		100

The cost of 100 shares from the s104 pool are matched to 100 of the 300 shares sold on 1 May 2017. This results in a gain of £300.

	£	£
Proceeds	100/300 x 1,500	500
Costs	100/500 x 1,000	(200)
Gain		300

Total gains on disposal are therefore £400.

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Calculating gains to working out how much CGT is due

We know how to prepare a simple capital gains calculation but there are a few further steps required to work out how much, if any, CGT is due.

Calculate gain → Apply adjustments (losses/reliefs/exemptions) → Taxable amount → Apply appropriate rate(s) of CGT

Once a gain has been calculated, the client then needs to consider any losses and the impact they may have on any CGT due.

Losses

Not all disposals will result in a capital gain. A capital loss will arise when net sales proceeds are less than the costs of acquiring the shares. Losses are generally calculated in the same way as gains.

Case study 3

Kate bought shares for £10,000 and sold them all for £5,000, so her capital loss is £5,000.

Capital losses arising in the same tax year as gains must be fully offset before the annual exemption is deducted. Every individual is entitled to an annual exempt amount. This amount is £11,300 in 2017/18 and means that in 2017/18 net chargeable gains – that is gains less losses – of £11,300 will be exempt from CGT.

Unfortunately, the set off of current year losses against gains in the same year can't be restricted to fully use up the annual exemption. This could potentially waste up to £11,300 of losses (in 2017/18) if the individual doesn't have enough gains to produce a net figure after losses equal to the annual exemption.

Case study 4

If Zara sells shares realising gains of £20,000 and losses of £10,000 in 2017/18, her net gains are £10,000. This will be covered by the annual exemption. However, £1,300 of her annual exemption (£11,300 in 2017/18) is effectively wasted.

The rules around the use of losses from earlier tax years differs from current year losses as shown in the next case study.

Allowable losses brought forward can (in contrast to current year losses) be restricted to preserve the annual exemption.

Case study 5

Peter has gains of £30,000 and losses of £10,000 in 2017/18. He has unused losses of £15,000 from 2015/16.

The losses of £10,000 are fully offset against gains of the same tax year. Losses of £8,700 from 2015/16 can be offset to leave gains in 2017/18 equivalent to the annual exemption.

£30,000 - £10,000 - £8,700 = £11,300 (covered by annual exemption)

Capital losses of £6,300 from 2015/16 are still available for carry forward to a future tax year.

Losses – other things to know

A capital loss must be claimed before it can be set against gains. It will only be allowed when the taxpayer gives notice and the time limit is generally 4 years after the end of the tax year that the asset was disposed of.

As well as selling an asset which realises a capital loss, some shares may simply become worthless or of negligible value and a claim may be made as if the shares had been sold. This allows the shares to be written off as a capital loss and relief given even though no actual disposal has taken place.

Generally, losses can't be carried back to an earlier tax year.

Special rules apply if capital losses are incurred by an individual in the tax year in which they die. These losses can be carried back 3 years prior to the tax year of death. Losses must first be set against any gains made in the tax year of death. The losses must be set against all gains, even if this reduces the net chargeable gains to below the amount of the annual exemption. If any allowable losses remain after this has been done, those excess losses may be carried back. The losses can be set off against gains arising in the 3 tax years prior to the tax year in which death occurs, but the losses must be set off against gains in a later year before making set-offs against gains of an earlier year. Losses carried back in this way are only set off so that the net chargeable gains are reduced to the amount of the annual exemption. The full benefit of the annual exemption is still applicable for those years.

Annual Exemption

As previously mentioned, every individual is entitled to an annual exempt amount meaning that in 2017/18 net chargeable gains of £11,300 of gains will be tax free.

Any unused part of the annual exemption is lost – it's a use it or lose it exemption with any unused exemption not available for carry forward!

Spouses and civil partners are entitled to their own annual exemption and it is not transferable between them. Where assets are held jointly any gain is generally split equally and each co-owner can use their own annual exempt amount against their share of the gain.

Generally, non-bare trustees, such as trustees of a discretionary trust, are entitled to half the annual exemption. This amount may be reduced where the settlor of the trust has set up more than one trust.

In the Autumn 2017 Budget, it's proposed to increase the annual exemption to £11,700 in 2018/19. This would mean that the annual exemption available to most trustees would increase from £5,650 to £5,850 in 2018/19.

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CGT rates

After deducting the annual exemption, the individual must consider the rate(s) of CGT that will apply to a gain. For shares sold by individuals and where CGT is payable, it will either be due at a rate of 10% and/or 20%. Higher rates of 18% and 28% may apply on disposals of certain residential property (eg second homes and buy to let) or carried interest.

CGT rates 2017/18

Taxpayer	Tax rate (%)
Basic rate	10
Higher and/or additional rate	20
Trustees and personal representatives	20

The CGT rate applying to a gain will depend on the individual's level of taxable income and their other chargeable gains after all allowable deductions including losses, personal allowance and CGT annual exemption have been allowed.

The Scottish Parliament has the power to set a Scottish rate of income tax for Scottish taxpayers. CGT has not been devolved to the Scottish Government and therefore a taxpayer's CGT position should be the same no matter where they reside in the UK. Scottish resident taxpayers with capital gains will require to apply the income tax thresholds applicable in the rest of the UK to establish the CGT rate to be applied to their taxable gains.

Case study 6

Andrew's taxable income (this is income after the personal allowance and reliefs are deducted) is £30,000 and his net capital gains from selling shares and after deducting the annual exemption is £2,000. The basic rate band in 2017/18 is £33,500. As the addition of the taxable gains to taxable income falls within the basic rate band, the gains of £2,000 will be subject to CGT at 10%, resulting in a CGT liability of £200. If Andrew's capital gains were £10,000 rather than £2,000, the addition of the gains to his taxable income would mean that some of his gains would attract CGT at 10% and some at 20%. In fact, £3,500 of gains would attract tax at 10% and £6,500 would attract tax at 20%, so that CGT of £1,650 would be due. If Andrew's taxable income exceeded the basic rate band in 2017/18, he would pay CGT at 20% on all of his gains.

When is CGT due to be paid?

CGT is payable by 31 January following the end of the tax year in which the disposal(s) giving rise to the CGT liability occurs. For disposals in the 2017/18 tax year, any CGT payable is due by 31 January 2019.

CGT isn't subject to payments on account and is usually paid in one lump sum by 31 January following the end of the relevant tax year.

Penalties and interest may be charged for late payment of tax.

HMRC reporting and filing deadlines

An individual is required to supply information about capital gains and losses to HMRC in certain circumstances.

They will need to be reported to HMRC if:

- gains (before taking off any losses) are > annual exemption; or
- sales proceeds are > (4 x annual exemption) even if chargeable gains < annual exemption; or
- an individual wishes to claim a capital loss or make a capital gains claim or election for the year.

An individual can report the capital gains tax they need to pay using HMRC's online real time capital gains tax service or annually in their self assessment tax return. Even if an individual uses the real time service they will need to report their gains again through self assessment if they are issued with a tax return for another reason. They will need to complete supplementary pages SA108 to report gains and losses.

The tax return filling deadlines are:

Tax return version	Filing deadline
Paper	31 October following the end of the tax year
Online	31 January following the end of tax year

For reportable disposals arising in the 2017/18 tax year, the reporting deadline is 31 January 2019.

Penalties are levied on late filing.

Married couples and civil partners

Transfers of assets between spouses and civil partners living together are treated as no gain, no loss transfers. This means that the receiving spouse obtains the asset at the original cost. The receiving spouse stands in the place of the spouse who originally acquired the shares.

A transfer of assets between spouses who are living together can save CGT when the assets are finally sold without any CGT or IHT liability on the transfer. It's important to note that such transfers must be outright and unconditional. The fact that a transfer of assets between married couples and civil partners doesn't trigger a disposal for CGT creates tax planning opportunities.

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Death

Capital gains are effectively extinguished when people die because there is a CGT uplift to the market value on death.

The assets of a deceased individual's estate are deemed to be acquired by their personal representatives at the market value on death though death in itself does not trigger an actual disposal. The estate is said to benefit from a CGT uplift on death.

Older clients with investments pregnant with gains can present difficult IHT and financial planning problems. It may be better to postpone a disposal until after they die to avoid the potential CGT but there are other factors to be considered to determine whether this is the right decision.

If you only read one thing read this:

- 'Disposal' covers many different types of transactions and includes sales, gifts, exchanges of assets.
- It's important to understand the share identification rules when selling shares.
- Capital losses and the annual exemption reduce taxable gains.
- For shares sold by individuals, the CGT rates that can apply will be 10% and/or 20%. These rates are considerably lower than the higher and additional rates of income tax. For high income individuals it may be desirable to choose investments aimed at capital growth rather than income.
- The HMRC reporting and payment deadlines should be met to avoid charges for late filing and payment.
- The ability to transfer assets between spouses without this giving rise to CGT presents tax planning opportunities, usually allowing the receiving spouse to use up their AE and or pay lower CGT rates than their spouse on a subsequent disposal.
- Death extinguishes gains so that beneficiaries of the deceased receive assets at the market value at date of death rather than the cost the deceased acquired those shares for.

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