

## **CAPITAL GAINS TAX – TAPER RELIEF**

A fundamental reform of the capital gains tax (CGT) system was made in 1998 for individuals, trustees and personal representatives. A number of further changes have been made in 2000 and 2001 and 2002.

A capital gain arises when certain capital (or 'chargeable') assets are sold at a profit. The gain is the sale proceeds (net of selling costs) less the purchase price (including acquisition costs). From this a deduction is made to reduce the gain to an amount which is taxable.

In some situations a major review of tax planning arrangements may be required because of the changes. Don't forget we are here to help.

**Please note taper relief does not affect company assets.**

### **THE 1998 CHANGES**

The pre-1998 system involved the deduction of an indexation allowance based on the increase in the retail prices index over the period of ownership of the asset. It was designed to remove the inflationary element of any gain.

The new rules replaced this with a taper relief which is based on the length of ownership and reduces the gain by a percentage. The percentage depends on the period of ownership of the asset and the type of asset - the percentage relief is higher for business assets (see definition below).

Where assets are sold after 5 April 1998 but were originally purchased before that date the calculation has to accommodate both sets of rules. Indexation is calculated up to April 1998. This is deducted from the gain before taper relief is deducted.

#### ***Amount of taper – non-business assets***

Taper relief is given by reference to the number of complete years of ownership after 5 April 1998. In addition a bonus year is added where the asset was acquired before 17 March 1998 (Budget Day).

The taper relief table is as follows.

Number of complete years asset held after 5.4.98 (including 'bonus' where relevant)	Non-business taper %
1	0
2	0

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3	5
4	10
5	15
6	20
7	25
8	30
9	35
10 or more	40

### **Example**

Bruce sold some shares in Glaxo plc for £19,000 in August 2002. They were acquired in 1984 for £5,000.

	£
Sale Proceeds	19,000
Less: Cost	<u>(5,000)</u>
	14,000
Less: Indexation (say)	<u>(4,000)</u>
(to April 1998)	10,000
Less: Taper relief x (5 years - 15%)	<u>(1,500)</u>
Chargeable Gain	£8,500

### ***Definition of business asset prior to 6 April 2000***

A business asset was defined as:

one used for the purposes of an individual's (or partnership's) trade shares in a qualifying trading company (ie either where there is ownership of 5% of the voting rights and the holder is a full-time working director or employee of the company or ownership of 25% of the voting rights)

an asset owned by an individual but used in the individual's qualifying trading company.

### **THE 2000 AND 2001 CHANGES**

Two areas of the taper relief legislation were affected:

the time frame over which business asset taper rises to its maximum

the definition of which shareholdings qualify for business asset treatment.

### ***Amount of taper***

For disposals made between 6 April 2000 and 5 April 2002 a new four-year taper for

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business assets applied. This operated retrospectively for holding periods from 6 April 1998 to 5 April 2002. The table for this is as follows. There is no bonus year.

Number of complete years asset held after 5.4.98	Business taper %
1	12.5
2	25
3	50
4 or more	75

### ***Business assets***

With effect from 6 April 2000, the following categories of shareholding are eligible for business asset taper relief:

all shareholdings in unquoted trading companies (whether or not the shareholder works in the business)

all shareholdings held by full-time or part-time employees in quoted trading companies  
shareholdings in quoted trading companies where the shareholder is not an employee but can exercise at least 5% of the voting rights

shareholdings held by full-time or part-time employees in non-trading companies provided they and their associates do not own more than 10% of the company.

Where shares only qualify as a business asset from 6 April 2000 onwards, please note that full business asset taper will not apply to the eventual gain if the disposal is made before 6 April 2010. Part of the gain will qualify for business asset taper and part for non-business asset taper. Please contact us if you require further information on this matter.

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#### THE 2002 CHANGES

For disposals of business assets after 6 April 2002 there is a new table.

Number of complete years asset held after 5.4.98	Business taper %
1	50
2 or more	75

#### Example

Bruce sold his 30% shareholding in Gordon Ltd for £190,000 in August 2002. It was acquired in 1984 for £50,000.

	£
Sale Proceeds	190,000
Less: Cost	<u>(50,000)</u>
	140,000
Less: Indexation (say)	<u>(40,000)</u>
(to April 1998)	100,000
Less: Taper relief (2 years + - 75%)	<u>(75,000)</u>
Chargeable Gain	£25,000

The CGT regime is therefore very attractive provided that the asset has been a business asset throughout the period of ownership (or since April 1998 if acquired earlier than April 1998).

#### RETIREMENT RELIEF AXED

Now that taper relief provides a rate of up to 75% for ownership of business assets - retirement relief continues to be phased out.

The relief still allows a substantial capital gain to escape tax when a business or shares in a personal company are sold by a taxpayer aged at least 50. (Interestingly the taxpayer doesn't have to retire to obtain the relief). Relief is also available where there is retirement due to ill health.

Currently, relief of up to £125,000 is given on gains in excess of £200,000.

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Tax Year	Full relief on first £000	50% relief on next £000
2001/02	100	300
2002/03	50	150
2003/04	nil	nil

Where retirement relief does not fully cover a gain, taper relief is given on the balance.

During the phasing out period the timing of disposals is critical. Delaying a disposal from this tax year to the next will cause a loss of retirement relief.

The maximum business asset taper is likely to have been reached in April 2002 and therefore a disposal in the 2002/03 tax year is likely to be beneficial.

## **MATCHING RULES FOR SHARES**

The main change in the matching rules has been that share sales are matched with the most recent acquisition. This results in the lowest amount of taper being given.

Assuming the shares in question are a non-business asset, no taper will be given on a shareholding which was acquired within three years of the sale. If however a sale is made in 2002/03 of non-business asset shares acquired before 5 April 1998, 15% taper will be given.

### *Use of annual exemption*

The annual exemption for 2002/03 is £7,700. The opportunity to make tax free gains up to this level should not be overlooked.

The sale and almost immediate repurchase of the same shares by the same person cannot however be used to generate a gain.

There are ways around this

Sell shares from your personal portfolio and repurchase through an ISA.

A sale by one spouse followed by the repurchase in the name of the other spouse.

Wait 30 days before repurchase (but be aware of financial risk due to share price movements).

### *Losses*

Capital losses must be set against gains before taper relief is calculated. In effect, the loss is tapered.

Where there are several gains made in the year the losses can be set against the gains in the order that produces the lowest tax charge. In effect losses should first be set against gains with the lowest taper relief.

### **Example**

Rosemary makes the following gains in 2002/03:

	£	Taper relief %
Asset 1	2,000	nil
Asset 2	15,000	75%
Asset 3	4,000	15%

She also realises a capital loss of £3,000

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	£	£
Asset 1: Gain	2,000	
Less: Loss	<u>(2,000)</u>	
		nil
Asset 3: Gain	4,000	
Less: Loss	<u>(1,000)</u>	
	3,000	
Less: Taper relief (15%)	2,550	(450)
Asset 2: Gain	15,000	
Less: Taper relief (75%)	<u>(11,250)</u>	
		3,750

Where losses are brought forward from earlier years, they only have to be used to the extent that the gains in the year are not covered by the annual exemption.

## **DEFERRING GAINS THROUGH EIS OR VCT INVESTMENTS**

The Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) schemes allow individuals to defer capital gains made on the disposal of any asset so long as the gain is reinvested in shares in a qualifying unquoted trading company (EIS) or a VCT.

The deferred gain crystallises on a subsequent disposal of the shares unless certain conditions are breached before that time.

Please note:

certain trades (eg property development and farming) are excluded  
the shares must be acquired by subscription - ie only new shares qualify  
the EIS scheme is complex and advice is essential.

### **HOW WE CAN HELP**

The taper relief provisions and the phasing out of retirement relief can dramatically affect the amount of CGT payable.

If you are contemplating retirement, or contemplating the sale of your business interests this year then timing of the sale will be critical. We would be happy to discuss the options with you.

Please also contact us if you are interested in deferring CGT liabilities using either the EIS or VCT schemes.

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