



Capital Taxes

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 since.

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.

Please note taper relief does not affect company assets.

How Taper Relief Works

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.

This system was replaced with 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
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 2004. They were acquired in 1984 for £5,000.

	£
Sale Proceeds	19,000
Less: Cost	(5,000)
	<hr/> 14,000
Less: Indexation (say)	(4,000)
	<hr/> (to April 1998)
	10,000
Less: Taper relief	(2,500)
x (6 years + bonus year 25%)	<hr/>
Chargeable Gain	<u>£7,500</u>

Amount of taper – business assets

For disposals of business assets after 6 April 2002 there is a different table (disposals prior to 2002 had yet another different table).

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



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Example

Bruce sold his 30% shareholding in Gordon Ltd for £190,000 in August 2004. It was acquired in 1984 for £50,000.

	£
Sale Proceeds	190,000
Less: Cost	(50,000)
	140,000
Less: Indexation (say)	(40,000)
	(to April 1998)
	100,000
Less: Taper relief (2 years + fi 75%)	(75,000)
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).

Definition of Business Asset

The following assets are currently eligible for business asset taper relief:

- one used for the purposes of an individual's (or partnership's) trade
- an asset owned by an individual but used in the individual's qualifying trading company
- property let to any trade
- 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.

The definition of a business asset has changed several times since the introduction of taper relief.

Change in the assets status

In some circumstances an asset will not wholly qualify for full business asset taper relief. This may be due to a change in the definition of business assets or because the asset has not always been used for a qualifying

purpose. In these circumstances part of the gain will qualify for business asset taper and part for non business taper relief. Please contact us for further information on this point.

Matching Rules for Shares

There have always been special rules to decide which shares have been sold where there is a part disposal of a shareholding in a particular company. In the taper relief system, 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 2004/05 of non-business asset shares acquired before 5 April 1998, 25% taper will be given.

Use of annual exemption

The annual exemption for 2004/05 is £8,200. 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.



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Example

Rosemary makes the following gains in 2004/05:

	£	Taper relief %
Asset 1	2,000	nil
Asset 2	15,000	75%
Asset 3	4,000	20%

She also realises a capital loss of £3,000

	£	£
Asset 1: Gain	2,000	
Less: Loss	(2,000)	
		nil
Asset 3: Gain	4,000	
Less: Loss	(1,000)	
	3,000	
Less: Taper relief (20%)	(600)	
		2,400
Asset 2: Gain	15,000	
Less: Taper relief (75%)	(11,250)	
		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 Investments

The Enterprise Investment Scheme (EIS) allows 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). The ability to defer gains against investments in Venture Capital Trusts was removed from 6 April 2004.

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 can dramatically affect the amount of CGT payable.

If you are contemplating the sale of your business interests soon please talk to us. We would be happy to discuss the options with you.

Please also contact us if you are interested in deferring CGT liabilities using the EIS scheme.