

Changes to Capital Gains Tax – as proposed in the Pre Budget Report of 9 October 2007 and revised by subsequent announcements by HM Revenue & Customs and Draft Legislation

‘Banking’ indexation

Background

Indexation relief can usually be claimed when an asset that was held prior to April 1998 is subsequently sold.

Indexation was introduced in 1982 and its purpose was to give relief from the effects of inflation when calculating the taxable gain of an asset. When calculating the taxable gain the original cost, together with an amount based on the movement in the retail price index (RPI) during the period of ownership, was deducted from the proceeds before deducted losses and the annual exemption and then calculating the tax due.

Current Situation

In 1998 when taper relief was introduced (which applies to individuals and trustees, but not to limited companies) indexation ceased. However it was, and currently still is, possible to claim indexation relief when an asset is sold, if part of the period when you owned it falls before April 1998.

Indexation relief on the sale of an asset can be quite significant, most of all for assets that have been owned since 1982 where the relief may amount to slightly more than the original purchase price.

Indexation relief, if it is applicable, can still be claimed on the sale of an asset, but only if the sale is before 6 April 2008.

Planning opportunity

However, based on the revised draft legislation, certain gifts of assets before the 6 April could be used to crystallize or ‘bank’ the indexation, without an actual sale taking place.

Instead the new owner should have a base cost equivalent to the original cost plus indexation relief up to the date of the gift, which would then be used to calculate the taxable gain for the new owner when they sell that asset, even if the sale takes place after 5 April 2008.

The main examples of gifts that could achieve this are:

- A gift of an asset from one spouse or civil partner to another (see note 1 below).
- A gift of an asset into and in some circumstances out of a trust (see note 2 below).
- A gift of a business asset, provided the asset meets certain criteria (see note 2 below)

If a gift is to be effective for tax purposes it has to be genuine, i.e. a gift where the transferor no longer has control over the asset and there is no obligation for it to be gifted back again to them at some future time.

Notes

1. By gifting assets between spouses other taxation implications may result for example income tax liabilities on subsequent dividends, rents or other income arising on the assets may be taxed at a different rate, depending upon the circumstances of the transferee.
2. Gifts to trusts, or to any person other than a spouse will have Inheritance Tax implications which must be fully considered before the gift takes place.
3. Care must be exercised in relation to shareholdings in family companies. In particular, assuming that the new CGT "Entrepreneurs' Relief" becomes law, it is very important that the shares are held by the spouse who works for the company in order to secure this relief on a future sale.

For further information on this or any other personal tax related issue please contact your usual Cooper Parry contact or:

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