Sanlam

Wealth

A guide to getting ahead of potential changes to capital gains tax

In the middle of last year, the Chancellor of the Exchequer asked the Office of Tax Simplification to conduct a review of capital gains tax. The first of two reports was published at the end of 2020 with suggested recommendations, and it is widely expected it will lead to changes in capital gains tax legislation, which may be announced in the Spring Budget in March.

Forewarned is to be forearmed

Capital gains tax falls outside of the Conservative Party's election promise not to raise taxes and is one way of starting to replenish the public purse after the ravaging effects of covid-19. Although it's not advisable to make changes to your investment strategy until new rules or changes to legislation are formally announced, we believe that capital gains tax allowances are likely to become less generous. As a result, investors should at the very least be maximising existing capital gains tax exemptions, as well as their pension and ISA allowances, since returns and withdrawals are free of capital gains tax.

This guide explains what capital gains tax is, what is likely to change, who will be affected and what you can do to protect your wealth. It's important that you seek the correct professional advice from your accountant and your financial planner about how these rumoured changes could affect you and how you can prepare accordingly.

What is capital gains tax, and who pays it?

If you come to sell, dispose of, or realise the value of an asset, you will need to pay capital gains tax on any gain you have made. Chargeable assets include company shares, investment properties and personal possessions that are worth more than £6,000 (apart from cars and your main home, assuming you have not rented it out or used it for business purposes).

Currently, everyone can make an annual capital gain of up to £12,300 (£6,150 for trusts subject to the number of trusts the settlor has set up) without paying any capital gains tax. That is called the capital gains tax annual exemption. For any gains over and above that, you will pay capital gains tax depending on your rate of income tax. If you are a higher-rate taxpayer, you will pay 28% on gains made from property sold which is not your main residence and 20% on gains from other assets. If you are a basic-rate taxpayer, you will pay 18% and 10%, respectively. Please note, though, that a capital gain is added to your income, so if it takes you into the higher income-tax bracket, you will be charged the higher rate for the amount over that threshold.

What are the suggested changes?

There are several rumoured changes to the capital gains tax rules:

1. Reduction of the annual capital gains tax exemption from £12,300 a year to between £2,000 and £4,000 a year.

   IMPACT: Our client is a higher-rate taxpayer and needs to cash in an investment that has grown by £100,000 since they invested. The capital gains tax exemption falls from £12,300 a year to £3,000 a year, which means they will pay capital gains tax on £97,000 rather than £87,700, increasing their bill from £17,540 to £19,400.

2. The rate of capital gains tax could rise to align with income-tax rates. An additional-rate taxpayer will therefore pay 45% on gains made above the annual exemption, a higher-rate taxpayer will pay 40%, and a basic-rate taxpayer will pay 20%.

   IMPACT: Our client is a higher-rate taxpayer and needs to cash in an investment that has grown by £100,000 since they invested. The rate of capital gains tax has increased from 20% to 40%, meaning their capital gains tax liability has doubled from £17,540 to £35,080, assuming they have utilised their annual exemption, which remains at £12,300 a year. If the annual allowance was reduced to £3,000 at the same time, their capital gains tax liability increases from £17,540 to £38,800.

3. Currently, if you leave an investment to a beneficiary in your estate, they will only pay capital gains tax on gains that have been made between the date they inherit the investment (market value on the date of death) and the date they encash the investment. However, it is thought that beneficiaries could be forced to pay capital gains tax on the total gain from the date the investment was made.

IMPACT: Our client sadly passes away, leaving their daughter an investment worth £200,000. The original investment was £100,000. The daughter is a higher-rate taxpayer and decides to cash in the investment immediately to help with school fees. As current rules stand, she would inherit £200,000, £100,000 of which is investment gains (not withstanding inheritance tax). However, a change in capital gains tax rules would mean that she inherits only £180,000, or £182,460 if she uses her annual capital gains tax allowance of £12,300.

Remember this is not an exhaustive list and these are only recommendations. Speak to your adviser for more details.

Who will be affected by these changes?

If you fall into one or more of the categories below, you should speak to your wealth planner, tax specialist and/or your financial planner now to ensure you make the most of current capital gains tax rules while you can:

1. If you have capital gains within your investment portfolio – especially if you are a higher-rate or additional-rate taxpayer, or you are on the threshold of moving up a tax bracket.
2. If you are a property investor.
3. If you are planning to leave capital gains in your estate for future generations to enjoy.
4. If you are a business owner who is planning to sell their business in the future.
5. Trustees with unwrapped portfolios within their trusts.

What should you do now?

It is important to always seek professional tax and financial advice before making any changes to your investments. This will ensure your agreed financial plan stays on track should the rumoured changes become law.

In preparation for any changes, your adviser may recommend you:

- Ensure you are taking advantage of the tax allowances and exemptions you have relating to income, capital gains and inheritance tax as well as maximising contributions to tax efficient savings vehicles such as ISAs, pensions and investment bonds.
- Reinvest some of your funds, thus crystallising the gain and effectively starting from zero again.
- Transfer assets to a spouse or civil partner in a lower tax bracket or one who hasn't used their allowances.
- Offset some capital gains by reporting any losses you have made on a chargeable asset to HMRC. Currently, you can carry forward unused losses from previous years indefinitely, so long as this is registered with HMRC within four years of when the loss occurred. This might change as part of the review, so it's worth ensuring you have maximised this opportunity.
- If you own an investment property and you think you might need the money soon, you may want to consider selling now. Alternatively, you can discuss releasing equity through a re-mortgage since that is currently out of scope for capital gains tax (although that may also change).

Sanlam accepts no liability for any action taken or not taken by an individual or firm as a result of the contents of this material. The tax treatments and information contained in this document is based on current tax law and HMRC practice as at January 2021 and may be subject to change in the future. Whilst we have made every effort to ensure the accuracy of this material, we cannot accept responsibility for any consequence (financial or otherwise) arising from relying on it. This document is for information purposes only and should not be treated as advice and independent taxation advice should be always sought Investing involves risk. The value of investments, and the income from them, may fall as well as rise. Investors may not get back the original amount invested. Past performance is not a reliable indicator of future results.

Sanlam Wealth is a trading name of Sanlam Private Investments (UK) Ltd, which is authorised and regulated by the Financial Conduct Authority. Registered in England and Wales 2041819. Registered office: Monument Place, 24 Monument Street, London, EC3R 8AJ.

enq@sanlam.co.uk

sanlam.co.uk