Sanlam

Wealth

Help your clients get ahead of potential capital gains tax changes

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.

Preparing clients for possible changes

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. While we don't know if or what changes will be made, we think it's worth ensuring your clients are, at the very least, maximising all current allowances and exemptions. The capital gains tax exemption can't be carried forward to the new tax year, and it is also important that clients maximise their pension contributions plus any carry forward and ISA allowances, since returns and withdrawals are free of capital gains tax and income tax.

Current rules at a glance

Currently, everyone has a capital gains tax annual exemption of up to £12,300 (£6,150 for trusts subject to the number of trusts the settlor has set up). Higher-rate taxpayers will then pay 28% on gains made from property sales which are not deemed to be a principle primary residence and 20% on gains from other assets, while basic-rate taxpayers will pay 18% and 10%, respectively. Capital gains tax is added to income, so be careful if your client is on the threshold of the next income tax bracket.

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: A 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: A 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 a client leaves an investment to a beneficiary in their estate, the beneficiary 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: A 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.

Who will be affected by these changes?

If your clients fall into any one of these categories, we recommend you review their financial plan as soon as possible:

- They have embedded capital gains within their investment portfolio.
- They are a higher-rate or additional-rate taxpayer, or they are on the threshold of moving up a tax bracket.
- They have a taxable portfolio that undertakes automated rebalancing without investigating ways to mitigate potential gains.
- They take income and/or withdrawals from a taxable portfolio.
- They are planning to leave capital gains in their estate for future generations to enjoy.
- They are a business owner who is planning to sell their business in the future.
- Trustees with unwrapped portfolios within their trusts.
- They are a property investor.

How can you help clients prepare for any changes?

- Ensure your clients are taking advantage of all the tax allowances and exemptions they 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.
- Consider reinvesting some of their funds, thus crystallising the gain and effectively starting from zero again.
- Discuss transferring 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 they have made on a chargeable asset to HMRC. Currently, they can carry forward unused losses from previous years indefinitely, as 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 they have maximised this opportunity.
- If they own an investment property, they 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).
- Consider moving some assets into an onshore bond since they are not subject to CGT while invested or on encashment.
- Charitable giving provides relief on both capital gains tax and income tax. So if it suits the client, gifting assets with capital gains is a very tax efficient way of supporting charities.

How Sanlam can help

Any change in tax legislation can be onerous on advisers. Should the Chancellor announce significant changes to capital gains tax allowances, our Technical team is on hand to support you with complex or trust related questions as required. To contact them, please email technical@sanlam.co.uk.

We also offer several products that can help with capital gains tax, and other tax mitigation. For example, we recommend you consider onshore bonds as part of your holistic financial planning offering, which we would be happy to discuss with you in more detail.

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