

CAPITAL GAINS TAX AND THE NEW COALITION GOVERNMENT

The new Coalition Government have announced that they intend to increase the rates of CGT. Although precise details will not be announced until the Emergency Budget on 22 June, this clearly gives rise to opportunities to plan for investors – both before and (depending on the detail of the change) after 22 June.

First, let's consider what changes are likely:

WHAT HAS HAPPENED UNDER LABOUR FROM 6 APRIL 2010	WHAT MIGHT HAPPEN UNDER THE COALITION
<ul style="list-style-type: none"> • Annual exemption of £10,100 per individual. • Flat CGT rate of 18%. 	<ul style="list-style-type: none"> • Annual exemption level may be reviewed. No announcement yet but Liberal manifesto mentioned £2,000. • Rate of CGT will be aligned at individual's marginal rate(s) of income tax – although this may be pegged to a maximum CGT rate of 40% - no comment on indexation allowance (or taper relief). • Rates of CGT on business assets “to be protected”.

PLANNING

CGT is one of the key areas in which investors will need to consider their planning options. The following sums up some of the key options available.

(i) Realising assets now

There are still a number of imponderables with CGT – most notably whether some form of indexation allowance or taper relief will be introduced and whether the CGT annual exemption will be reduced or not. Irrespective of this, it seems certain that the rate of CGT will increase although we don't know from when and by how much.

And it's this question that creates the difficulties for those investors who may be considering making disposals now. The change in the rate of CGT could take place from either:

- the date of announcement – ie. emergency Budget Day on 22 June 2010
- 6 April 2010

- 6 April 2011

Despite this uncertainty, certain obvious planning points nevertheless arise:-

- If a person is seriously thinking about realising a capital gain by selling an asset then, subject to commercial considerations, it may be better to do that sooner rather than later; a CGT saving of 22% could accrue (40% v 18%).

And this saving takes no account of any possible future reduction in the annual exemption.

Clearly, it is of considerable importance that professional advice is taken in advance of any action and realisation should only take place if it makes absolute commercial sense to do so. The tax tail should not be allowed to wag the dog.

- If an investor wishes to realise an asset but continue to benefit from its value in the future, consideration could be given to a so-called “bed and SIPP” or “bed and ISA” transaction. The “bed and SIPP” route gives the added advantage of tax relief on the pension contribution-within the usual rules of course. Both offer the attraction of a future CGT free shelter for gains.

Alternatively, consideration could be given to a transfer of the asset to a settlor-interested trust but this would give rise to a chargeable lifetime transfer for IHT purposes and so care should be exercised not to exceed the available nil rate band.

On the disposal of an asset now, any CGT payable could be deferred, for example, by investment into an EIS.

(ii) Investment to minimise the future impact of CGT

If CGT rates increase, investors will be keen to invest in areas that reduce the scope for CGT to damage their portfolios in the future. Relevant issues here are as follows:-

(i) ISA

The ISA will become even more important as a planning tool. Tax freedom in an environment of higher rates of tax is very attractive. Don't forget that between spouses can each invest £10,200 per annum – that's £204,000 jointly over 10 years.

(ii) Offshore Bonds v Collectives

One of the key areas that will be affected by a hike in the CGT rate is the investment bonds versus collectives choice. And given the increase in income tax rates – particularly the introduction of the 50% rate, - it seems likely that offshore bonds will become very much more important as a means of achieving future tax deferral on an investment.

So how will offshore bonds compare with collectives in the new CGT world?

Well, currently as a generalisation, for a higher/additional rate taxpayer, collectives are currently “tax preferable” as a home for capital growth producing assets and offshore bonds as a wrapper for high income yielding investments. More careful thought is needed with ‘balanced funds’ where advice is essential, especially for the more significant investments.

An increase in the rate of CGT will, undoubtedly, improve the comparative position of the offshore bond as a wrapper for mixed portfolios – especially for investors who expect to fully use their CGT annual exemption. However, given that most people will have a CGT annual exemption of currently £10,100 available, CGT on encashment should not be too much of an issue for most investors in collectives unless substantial gains are anticipated. Of course, if the CGT annual exemption was reduced to, say, £2,000 this would have an enormous impact and could tip the balance back in favour of offshore bonds even where underlying assets deliver capital growth.

For the higher rate taxpayer, the offshore bond offers considerable attractions on the basis that underlying investments will be accruing in an environment that does not suffer income tax **or** capital gains tax. As well as delivering this long-term tax deferral, it also offers flexibility on removal of benefits.

Whilst on encashment of an offshore bond any profit (chargeable event gains) will be taxed as the top part of the investor’s income, there are various encashment strategies that can be adopted to reduce tax at that time. For example, the bond could be assigned to a lower rate or non-taxpaying spouse/child or (adult) grandchild prior to encashment so that any tax charge then arising is minimised or the investor may migrate to a lower tax environment.

These are some of the reasons why some commentators have suggested that the next CGT regime will see a move from collectives to investment bonds - particularly offshore bonds. On the other hand there will be a case for multi-manager and fund of funds permitting fund changes to take place within the “master fund” without any disposal for CGT purposes by the investor taking place. This might be true, but until all the details are available such ideas may be no more than speculation.

This document is provided strictly for general information purposes only. No action should be taken or refrained from being taken on the basis of this document alone. Accordingly, no responsibility can be assumed for any loss

occasioned as a result of any such action or inaction. Professional advice must always be taken by an individual before any action is taken or refrained from.