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Office of Tax Simplification - Capital Gains Tax Review

The Office of Tax Simplification (OTS) has recently issued its first report regarding a review of Capital Gains Tax (CGT) requested by the Chancellor, Rishi Sunak, in July. The first report considers the policy design and principles underpinning the tax; the second, which will follow early next year, will explore technical and administrative issues.

The report has made a number of recommendations regarding potential changes to CGT. The Chancellor will need to consider whether to implement any or all of the recommendations in the next Budget in March 2021.

Many of the recommendations are likely to have downsides for the taxpayer. The main ones are as follows:

1. **More closely aligning CGT rates with Income Tax rates**

   The current rates of CGT are lower than standard Income Tax rates: the maximum rate of CGT is 28% for residential property gains and 20% for non-residential property gains, compared to a maximum Income Tax rate of 45%.

   The OTS report suggests the Government should consider more closely aligning CGT rates with Income Tax rates.

2. **Taxing retained profits in smaller companies at Income Tax rates on liquidation or sale**

   At present, the value of any retained profits remaining within a company at the time of winding up or sale of the company will form part of the value of the final distribution or sale proceeds, which will be charged to CGT.

   The OTS report recommends considering taxing the retained profits of smaller companies at Income Tax rates. A company is currently treated as 'small' if it has any two of: a turnover of £10.2 million or less, £5.1 million or less of gross assets, 50 employees or less.

   The intention behind this recommendation appears to be to prevent an advantage being gained from sheltering profits in small companies.

3. **Reducing the Annual Exemption**

   The Annual Exemption (currently £12,300 in the tax year 2020/21) is a threshold below which an individual's overall capital gains are not taxed.

   The OTS report suggests that the Annual Exemption should be reduced to £5,000 or below so that it operates as a de minimis threshold.

4. **Removing the uplift on death where Inheritance Tax (IHT) relief applies (or more widely but with a rebase to 2000)**

   The OTS report suggests the Government should reconsider the way CGT and IHT interact.

   At present, business and agricultural assets can, subject to meeting certain conditions, benefit from 100% relief from IHT on death and, at the same time, the value of the business and assets is uplifted for CGT purposes to the value at the date of death.

   In addition, an inheritance from a spouse is exempt from IHT and the value is uplifted for CGT purposes to the value at the date of death.

   The OTS report suggests that a taxpayer should not get both an IHT exemption and a CGT uplift on death. It therefore recommends the following:

   - Where a relief or exemption from IHT applies, the Government should consider removing the CGT uplift on death and instead provide that the recipient is treated as acquiring the assets at the historic base cost of the deceased.

   - Indeed the OTS goes further and suggests the Government should consider removing the CGT uplift on death altogether and instead provide that the person inheriting the asset is treated as acquiring the asset at the historic base cost of the deceased.

   If this recommendation is implemented, the Government should consider a rebasing of assets, perhaps to the year 2000.

5. **Tightening Business Asset Disposal Relief so that it is for interests of 25% and above held for 10 years plus or with a minimum age threshold**

   Business Asset Disposal Relief reduces the CGT payable on the disposal of qualifying business assets by charging the gains at a special rate of 10%.

   Currently for sales of shares in trading companies the minimum shareholding is 5% and the minimum ownership period is 2 years.

   The OTS report suggests the Government considers:

   - Increasing the minimum shareholding to perhaps 25%, so that the relief goes to owner-managers rather than more passive investors.

   - Increasing the ownership period to perhaps 10 years, to ensure the relief only goes to people who have built up their business over time.

   - Reintroducing an age limit, perhaps linked to the age limits in pension freedoms, to reflect the intention that it should mainly benefit those who are retiring.

Conclusion

While a number of the recommendations would result in additional CGT being paid by taxpayers, it is not yet known whether any or all of the recommendations will be implemented.

Nevertheless it is prudent to review one's overall affairs in light of the potential changes. In particular consideration might be given to bringing forward disposals of assets standing at a gain before the Budget to take advantage of the current favourable rates of CGT. These are difficult times for the Government but also for individuals and it is a delicate balancing act for everyone, whilst today's tax landscape is beneficial and may lead one to consider bringing forward transactions, caution is also needed given this may accelerate the actual payment of tax.

Does this issue raise any questions in your mind?

Would you like more information on a particular item?

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