Guide to Capital Gains Tax

Hargreaves Lansdown

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Important Investment Notes

This document is published solely to help UK resident clients make their own investment decisions. It does not constitute personal advice. Should you have any doubt as to the suitability of an investment for your circumstances you should seek expert advice. All investments should be held for the long term as their value can fall as well as rise, therefore you could get back less than you invested. Neither capital nor income is guaranteed. Cancellation rights may not be available.

The information in this guide is based on our understanding of current and draft legislation which can change. The levels and the basis of, as well as reliefs from, taxation referred to are those currently applying or proposed and are subject to change. Their value depends on your individual circumstances.

Tax is notoriously complex and we cannot replicate every rule, nuance or exemption here. Therefore you should not make, or refrain from making, any decisions based on this information alone. HMRC's capital gains tax (CGT) help notes and helpline will provide further guidance should you need them.

If you are in any doubt as to the suitable course of action we recommend you seek tax advice. This guide is issued by Hargreaves Lansdown Asset Management Ltd, One College Square South, Anchor Road, Bristol BS1 5HL, who is authorised and regulated by the Financial Conduct Authority (FCA). April 2017

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Introduction

From 2013/14 to 2015/16, official figures show the number of people paying capital gains tax (CGT) increased by 43% and the amount of CGT collected rose by 80%. The Office for Budget Responsibility estimates that revenue from CGT will be £9.1bn this year, exceeding what is collected from inheritance tax (IHT) by over 80%.

These facts shouldn't surprise you. Rising asset values, higher numbers of transactions and almost frozen allowances have pushed up the tax collected. Budget 2016 provided some welcome CGT respite for investors with the tax rate now 8 percentage points lower than in recent years. But this does not apply to second homes or investment properties and higher rate CGT will still dent your investment profits by a fifth in most cases.

Increases in property taxes

Furthermore, increases in stamp duty on additional residential properties and cuts in residential property buy-to-let tax reliefs mean that many are facing higher tax bills. A change to how quickly CGT needs to be paid by some landlords (from April 2019) could increase the number of people selling property and taking gains.

This guide is written to help investors understand the rules, and consider taking steps wherever possible to avoid paying unnecessary capital gains tax.

We always warn that tax rules are subject to change. You never know when things might change in the future, so we believe it's best to make use of tax allowances and tax breaks while they are still available providing it is suitable for your circumstances.

What is capital gains tax and who pays it?

Capital gains tax (CGT) is charged upon the disposal of certain types of asset. A disposal is when the ownership of the asset changes, which would normally be by sale, transfer or gift, or exchange, in part or as a whole. It is important to note that without a disposal, there is no CGT to pay, so it is a tax which can be deferred indefinitely.

CGT is paid by UK residents and by non-UK residents on gains from UK assets (generally property and investments). CGT can also be charged on the disposal of overseas assets.

Which assets are liable to capital gains tax?

Assets which are subject to CGT

- Shares
- Funds
- Investment trusts
- ETFs
- Land
- Investment and second properties
- Certain possessions, such as works of art, worth £6,000 or more

Assets which may be exempt from CGT

- The family home*
- Most chattels (personal possessions)
- Assets which depreciate in value e.g. private cars (unless used for business)
- UK government bonds (gilts)
- ISA investments
- Pension investments
- Venture Capital Trusts (VCTs)
- Enterprise Investment Schemes (EIS)

**In most cases your principal private residence is exempt, however there are some exceptions, for example if you rent part, or your property is on land bigger than one acre. This is covered in more detail on page 11.*

Capital gains tax allowances and reliefs

Capital gains tax allowance

The annual exempt amount, more commonly known as the capital gains tax allowance, is an annual tax free allowance. As long as the total of your realised gains in any one tax year is below this amount (after deducting any losses and applying any reliefs) there is no CGT to pay. Importantly, if you do not use your CGT allowance in a tax year, you cannot carry it forward to another tax year and it will be lost forever.

The annual CGT allowance is £11,300 for tax year 2017/18. The annual CGT allowance for trusts is half of this, £5,650 for tax year 2017/18.

Capital gains tax reliefs

There are various reliefs and exemptions which may reduce the amount of CGT to be paid.

- **Expenditure and costs**
  In some cases, money spent on increasing an asset's value, together with the transaction costs of acquisition and disposal, can be deducted.

  For example, in the case of a property, investing in improvements such as an extension can be offset against CGT, but not the cost of maintenance such as redecorating. In the case of shares, you can reduce the gain by the costs of buying and selling the shares.

- **Losses**
  If an asset is sold at a loss, the loss can be offset against any gains made in the same tax year. If there are more losses than gains, these can be registered on a tax return and carried forward to offset against future gains in later tax years.

- **Business assets**
  Business assets may be treated more generously due to entrepreneurs' relief. Business assets are generally a share (or interest) in the company or firm you work for. You have to hold at least 5% of the shares and voting rights to qualify. Entrepreneurs' relief, where available, reduces the capital gains tax rate to 10% for the first £10m of gains. This has now been extended for longer-term investors in unlisted companies, who benefit from a 10% rate on lifetime gains up to £10m.

  CGT relief may also be available when disposing of a property that was a business asset. For details go to www.gov.uk/tax-sell-property/businesses

How capital gains tax is calculated in three easy steps

1

Calculate your capital gain

The capital gain is broadly the difference between the disposal proceeds and acquisition cost, often referred to as the base cost. You need to calculate your total gains in a tax year.

For example, if you sold £56,300 worth of shares which you purchased for £30,000, your total gain would be £26,300, assuming there are no transaction costs (£56,300 – £30,000 = £26,300).

2

Deduct the annual allowance from the gain

You can offset your annual CGT allowance against your gains.
The amount to be taxed is the total gain minus the annual CGT allowance:

Assuming that you have not realised a loss on other investments, the amount to be taxed
= £26,300 - £11,300
= £15,000

3

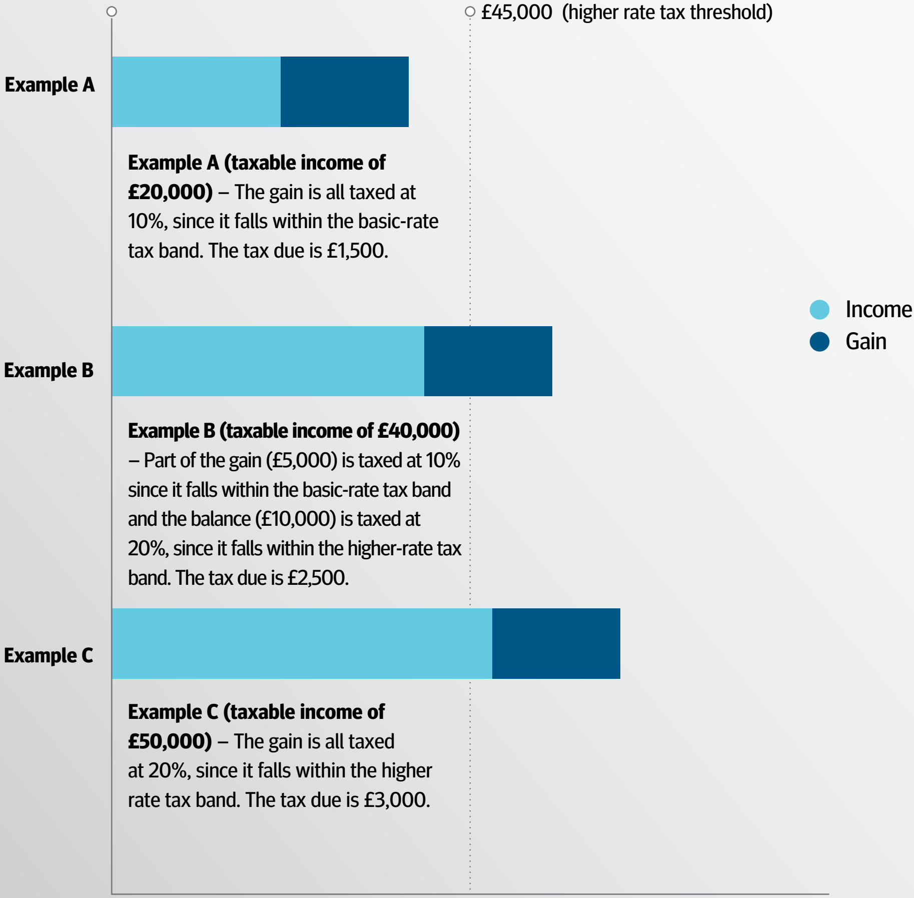
Calculate the capital gains tax to be paid

Capital gains tax (CGT) is normally charged at either 10% or 20% depending on an investor's other taxable income in that year. The gain is added to all the other taxable income in that tax year to assess the rate(s) of tax paid. Gains on investment property are taxed at 18% and 28%, dependent on other taxable income.

If the gain falls into two bands, perhaps taking income from the basic to the higher rate, an investor will pay capital gains tax at 10% (or in some cases 18%) on the amount which falls in the basic-rate band and at 20% (or in some cases 28%) on the amount which falls in the higher-rate band. Scottish taxpayers should use the UK tax bands for working out how much CGT is due. See examples on the next page.

How the CGT rate works

You can see some examples of how CGT is calculated from the illustration below. Example A is for an individual with a taxable income of £20,000, Example B is for an individual with a taxable income of £40,000 and Example C is for an individual with a taxable income of £50,000. The amount to be taxed in each case is £15,000, and the higher rate tax threshold is £45,000.



Example A (taxable income of £20,000) – The gain is all taxed at 10%, since it falls within the basic-rate tax band. The tax due is £1,500.

Example B (taxable income of £40,000) – Part of the gain (£5,000) is taxed at 10% since it falls within the basic-rate tax band and the balance (£10,000) is taxed at 20%, since it falls within the higher-rate tax band. The tax due is £2,500.

Example C (taxable income of £50,000) – The gain is all taxed at 20%, since it falls within the higher rate tax band. The tax due is £3,000.

Tax rules can change and benefits depend on personal circumstances

When capital gains tax is paid

The timing of when you make disposals can make a big difference to when the CGT is paid.

When the gains made exceed the annual capital gains tax allowance the CGT liability has to be declared in your self-assessment tax return for the year in which the disposal was made, and settled no later than 31 January in the following tax year.

This means that gains realised on 5 April 2017 must have their CGT settled by the end of January 2018, a period of nearly 10 months.

However if gains were realised on 6 April 2017, just a day later, the CGT would not have to be settled until 31 January 2019, a period of nearly 22 months. This is because the gain falls into a new tax year, 2017/18. The ability to time disposals to defer tax liabilities can provide helpful tax planning opportunities.

Future changes

Looking ahead, CGT liabilities on the sale of investment property will be payable within 30 days of the date of the disposal from April 2019, significantly reducing the time taxation can be deferred.

The final rules are not yet available, however this could be an important consideration if you expect to make large gains from property over the next few years.

Capital gains tax on shares and investments

Working out the gain on a share or fund is normally straightforward: the original base cost is deducted from the proceeds to calculate the gain. However, it becomes more complex when original holdings are topped up and additional shares or funds are bought. You can work out the gain using the following process:

EXAMPLE

You buy **1,000** shares at a price of **80p**. The total cost is **£800**.

A year later you buy another 3,000 shares at a price of 120p. The cost is £3,600.

In total, you now have **4,000** shares which cost **£4,400**

The average base cost of each share is **£4,400/4,000 = 110p**

Subsequently you decide to sell **1,500** shares at **125p**, total proceeds being £1,875.

The average base cost is **1,500 x 110p = £1,650**, meaning the gain is **£1,875 – £1,650 = £225**

Establish which shares are being sold first

This will help you to establish the base cost. You must work out which shares you are disposing of. Shares are treated as being disposed of in the following order:

1 Shares bought or acquired on the same day as the disposal - known as the "same day" rule. The base cost is the actual acquisition cost of the shares.
2 Shares bought or acquired in the 30 days following the day of disposal (the 'Bed & Breakfasting' rule). The base cost is the actual acquisition cost of the shares
3 All other shares. These are known as your "Section 104 holding" or "pooled" shares.

The base cost of the Section 104 holding for CGT purposes is the average base cost across all the holdings. You'll need to work out the average cost of your shares and deduct this from the disposal proceeds to work out your gain. The calculation is different if the shares have been held since 31 March 1982. HMRC help sheet 284 has more details (please see page 16 for more information).

Share reorganisations e.g. rights and bonus issues, or the issue of shares on a company takeover

These corporate actions are not treated as acquisitions. See HMRC help sheet 285 Share reorganisations, company takeovers and CGT (please see page 16 for more information).

Allowing for expenses

Your gain is reduced by the expenses incurred when buying and selling shares. These include stockbroking fees and any Stamp Duty or Stamp Duty Reserve Tax (SDRT) paid when you bought the shares.

Collective investments e.g. unit trusts

Reinvested dividends (income) are not liable for capital gains tax. However they may be liable for income tax. These reinvestments are allowed as additional expenditure in your CGT calculation. Essentially they increase the base cost.

Accumulation units

Accumulation units do not receive distributions of income. Instead, the income is retained and reinvested automatically, this is known as a notional distribution. You do not receive any new units, but the value of your existing units is increased.

Notional distributions are generally subject to income tax (unless held within an ISA or pension) but not capital gains tax. These notional distributions are allowed as additional expenditure in your CGT calculation.

If you hold accumulation units within a Hargreaves Lansdown Vantage Fund & Share Account, we will detail what income has been reinvested on your consolidated tax certificate which we will send you shortly after the end of the tax year.

Therefore, in order to ascertain any capital gains tax that may be payable, you simply need to deduct any income that has been reinvested from the proceeds of the fund once you have sold it.

When you don't pay capital gains tax

You don't usually need to pay CGT:

- When you give shares or funds as a gift to your spouse or to a registered charity.
- When you sell shares or funds in an ISA or pension.
- When you sell the first £50,000 worth of 'Employee Shareholder' shares (for which you will have given up certain employment rights) or any shares within employer Share Incentive Plans (SIPs).
- When you contribute shares from an employer Save As You Earn (SAYE) into an ISA within 90 days. CGT may apply if these shares are contributed to a pension.
- When you sell (dispose of) UK government gilts, Premium Bonds or qualifying corporate bonds.

Capital gains tax and property

Principal and private residence (the family home)

There is normally no capital gains tax to pay on the sale of a family home. The majority of residential properties benefit from full capital gains tax relief under the Private Residence Relief rules. There are some exceptions: properties on more than half a hectare (just over an acre, approximately half an international rugby pitch) of land and/or which have been used for rental or business purposes (see below), even in part, may be subject to some CGT on sale.

Investment, buy to let and second property

Investment, buy to let and second properties are all subject to capital gains tax when the property is sold or transferred. Capital gains tax on these properties is charged at 18% or 28%, depending on other taxable income in the tax year.

The average UK property has been in a bull market for a few years and in some areas prices have risen by over 20% in a year. With rising values comes an increase in gains and the potential for more CGT.

Reducing or managing the amount of CGT payable on the disposal of a property is not as easy as it is with a share or fund portfolio. It is normally unworkable to dispose of part of a property asset annually to use up the CGT allowances.

You can deduct costs of buying, selling or improving the property from the gain. These include: estate agents' and solicitors' fees, costs of improvement works, e.g. for an extension, and stamp duty land tax.

Capital gains tax relief on properties

CGT relief may be available where:

- The property was a business asset. For more details go to www.gov.uk/tax-sell-property/businesses
- It was your home but you rented part of it out. For more details go to www.gov.uk/tax-sell-home/let-out-part-of-home
- If the property was occupied by a dependent relative. See HMRC Helpsheet 283 for more details.

Seven steps to reduce capital gains tax

There are many steps which can be taken to minimise the tax on capital gains which might be payable:

1

Use the annual capital gains tax allowance
The capital gains tax allowance is £11,300 for 17/18 meaning a married couple (or those in a registered civil partnership) can make gains of £22,600 a year without any charge to tax. Investments can normally be transferred between spouses without an immediate tax charge to make full use of both their allowances.

2

Offset losses against gains
If an investment is sold at a loss, the loss is normally offset against any gains made in the same tax year. If there are more losses than gains, these can be registered on a tax return and carried forward to offset against future gains.

3

Sell when tax is paid at a lower rate
The rate of capital gains tax is charged based on the rate of income tax paid. If taxable income will fall in the future, perhaps due to retirement, consider delaying selling until then.

4

Transfer to spouse and pay less tax
Married couples (or those in a registered civil partnership) where one spouse pays tax at a lower rate than the other, may have the option to transfer investments into their name before selling to lower the rate of CGT paid.

5

Use ISAs to reduce taxable income

Because capital gains tax is linked to the rate of income tax paid, reducing taxable income could also reduce the amount of capital gains tax paid. One of the easiest ways to do this is to fully use tax shelters such as ISAs - income from an ISA is free from UK Tax. There is also no Capital Gains Tax to pay on assets held in an ISA.

Use pensions to reduce capital gains tax

6

If you would otherwise pay income tax at the higher rate, it may be possible to reduce capital gains tax liability by making a pension contribution, and receive tax relief on the contribution. If you're a UK resident under the age of 75, the general rule is you can contribute as much as you earn to pensions and receive tax relief each tax year. Contributions are subject to the annual allowance, which is £40,000 for most people. Effectively the basic-rate tax band is increased by the amount of the pension contribution, meaning larger gains might be realised before the higher rate of capital gains tax is payable. For example, a pension contribution of £3,600 could extend the basic-rate tax band from £45,000 to £48,600. Then, providing taxable income and gains are less than £48,600 in this tax year, capital gains tax will be paid at 10% and none at 20%.

7

Give shares, land or property to charity

Gifts of property, land or shares to charity can be highly tax efficient and save CGT as well as other taxes. There are two ways in which this can be done:

- **A direct gift of the asset**

If shares, land or property are gifted to a charity there is no CGT to pay, the charity receives the value of the asset tax free and there are no tax consequences for the investor. Furthermore there are no IHT consequences to worry about.
Income tax relief is also available on the value of the shares or assets gifted. Gifting an asset to charity can work well where there is a large, taxable capital gain.

- **Sell the asset and then gift the cash**

If shares, land or property are sold and then the value gifted, capital gains tax may be payable if the asset has increased in value. However, Gift Aid should also be available on the value of the money gifted. Therefore, selling the asset before gifting the proceeds works well where the capital gain is small, within the annual capital gains tax exemption, where there are losses which can be offset against other gains, or the value of the Gift Aid will outweigh any CGT liability.

Our Services

About Hargreaves Lansdown

Hargreaves Lansdown is a leading provider of investment management and pension products and services to private investors and employers in the UK.

Founded in Bristol by Peter Hargreaves and Stephen Lansdown in 1981, today we administer £70 billion of client assets on behalf of 876,000 investors (31st December 2016). We are listed in the FTSE 100 as one of the largest companies in the UK.

Whether you're an experienced investor, just starting out or want to leave it to an expert, we can offer the right investments for you, with over 2,500 funds, shares, investment trusts and many others to choose from.

We offer tools, watchlists and the latest research to help you make investment decisions whenever you want.

The HL Vantage SIPP and the HL Vantage Stocks & Shares ISA offer shelter from capital gains and other taxes:

VANTAGE STOCKS & SHARES ISA

An ISA (Individual Savings Account) is a popular way to invest or save, and allows you to benefit from generous tax breaks offered by the government.

The Vantage Stocks & Shares ISA offers an easy-to-manage, tax-efficient way to help your money grow. This tax year you can invest up to £20,000 in ISAs (the tax year runs from 6 April 2017 to 5 April 2018). To find out more about the HL Vantage Stocks & Shares ISA, please visit **www.hl.co.uk/investment-services/isa** or call our helpdesk on **0117 900 9000**.

HL VANTAGE SIPP

A SIPP (self-invested personal pension) is one of the most tax-efficient ways of saving for your retirement. The HL Vantage SIPP helps you to stay in control and manage your pension online 24/7.

More than 260,000 investors have already chosen the Vantage SIPP, and we've been voted Best SIPP Provider 10 years running by What Investment readers.

To find out more about the HL Vantage SIPP, please visit **www.hl.co.uk/pensions/sipp** or call our pensions helpdesk on **0117 980 9926**.

Please remember the value of tax shelters will depend on your circumstances and tax rules can change.

Hargreaves Lansdown Financial Advice

A free, no-obligation consultation

Our Financial Advisers can offer financial advice when you're facing important decisions or a departure from your normal situation. Adjusting to a change to your personal circumstances, employment status or income tax position, receiving an inheritance, or recognising you do not have the time or certainty to make your own financial decisions are just a few examples of when we can help.

Our advisers are highly qualified financial planners and can advise on the use of financial products and their respective taxation to assist in tax planning. They are not tax specialists and will recommend the services of an accountant or tax specialist to confirm any required calculations of existing or potential capital gain tax liabilities.

To discuss your needs and find out more about our advisory services please contact our Advisory Helpdesk on 0117 317 1690 (Mon-Fri 8.30am - 6pm) for a free initial consultation. There is no obligation to proceed. If you are happy to make your own investment decisions, we can help by providing resources and support. However, should you be unsure of the suitability of an investment for your personal needs, we can put you in touch with one of our advisers.

Please call 0117 317 1690 for your free consultation or for more information go to www.hl.co.uk/advice.

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Contact us

The specialists on our Investment Helpdesk are available to answer any queries you may have:

Monday - Thursday 8am to 7pm
Friday - 8am to 6pm
Saturday - 9.30am to 12.30pm

0117 900 9000

www.hl.co.uk

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Help From HMRC

HMRC offer additional support and guidance on CGT issues through various helpsheets:

www.gov.uk/government/collections/self-assessment-helpsheets-capital-gains

0300 200 3300

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