

CGT – Update on likely changes following meeting with HMRC

Many UK investors have been on edge since the announcement in October's Pre-Budget Report that Capital Gains Tax (CGT) rules would be overhauled from next April, including the elimination of Taper Relief and a new 18% flat rate. John Barnett, a Partner specialising in Corporate Tax at Burges Salmon, attended a meeting on 21 November 2007 with some senior officials at Her Majesty's Revenue & Customs (HMRC), where the issue of the proposed changes to the CGT system was discussed.

Rather than an overview of the proposed changes, this note presents only an update on some points raised in the meeting. Anyone wishing to begin with a more basic overview of the changes may be interested in the article "Stop Press – CGT Changes" found at http://www.burges-salmon.com/publications/content/Changes_to_Capital_Gains_Tax.pdf. The 18% rate looks likely to stay. Alastair Darling has re-emphasised his commitment to this. Subject to the Parliamentary process, this therefore looks to be a running certainty.

- 1 While Chancellor Alastair Darling says that he is "considering" some form of relief for small businesses, there are currently no proposals (and no draft legislation) for a *de minimis* exemption of £100,000.
- 2 Frozen gains, such as those relating to Qualifying Corporate Bonds (QCBs) and Enterprise Investment Schemes, which unfreeze after 6 April 2008 will have no taper relief - i.e. they will be at 18%.
- 3 Offshore trusts will have a 28.8% rate for capital payments after 6 April 2008. HMRC are "looking at the position" where capital payments are made ahead of the gain e.g. capital payments this year matched with gains of next year.
- 4 Inter-spouse transfers do work to bank the indexation. They are also aware of the fact that this doesn't technically work for pre-March 1982 assets but, interestingly, they intend to correct this problem in favour of the taxpayer.
- 5 Holdover relief and QCBs should also bank the indexation relief. Change in profit sharing ratios under partnerships (under Statement of Practice D12) may also serve to do this, but HMRC are looking at this further.
- 6 There are no plans for new anti-avoidance provisions ahead of 6 April. HMRC accept that taxpayers need a reasonable period (determined to be 6 months) to re-organise and that disposals may well be brought forward or delayed. They are broadly comfortable with the use of options, conditional contracts, defeasible contracts and other methods to change the tax point, although they may counteract highly artificial arrangements if any come to light (this is thought to be unlikely).
- 7 HMRC are actively considering a deemed market value election allowing a deemed disposal ahead of 5 April for those who want to rebase but pay the tax.
- 8 Regarding share identification, the suggestion is that a new "2008 pool" will be created at midnight on 5 April 2008 which will be treated as a single asset with a base cost equal to the base-cost of the individual components of it, but no indexation. Future disposals will be treated as a part disposal of that asset. Same day transfers and 30 day "bed and breakfast" rules will remain, and there will be some transitional rules until 4 May 2008 where the 30 day matching would take one back before 5 April.
- 9 HMRC are actively looking at whether s77 settlor interested trusts are still needed now that the rate will be the same. Holdover to settlor interested trusts will remain, however.

- 10 They are looking at whether s162 incorporation relief should become automatic again as the only reason an election was made available under s162A was where those incorporating accidentally lost out on taper relief.
- 11 They are looking at s129 and the position where shares in Company A are exchanged for shares of more than one class in Company B. Where Company B is unquoted the current rule is that one doesn't apportion the base-cost until the first disposal takes place, not at the date of the exchange. They will look at whether this might be changed (or have an election) so that taxpayers could, if they want, choose to make the apportionment at the date of exchange instead.
- 12 There are no plans for a general rebasing of assets (as when March 1982 values were introduced in 1988). The cost to the Exchequer and the huge amount of work for District Valuers and Shares Valuation Division are cited as the reasons.
- 13 They are aware of the problems for many, including farmers (who not only lose taper relief but also indexation). This is stated to be a consequence of simplification, although they did comment that farmers might "find some relatively easy ways of banking their indexation" (presumably this refers to inter-spouse transfers).
- 14 They will consider whether varying an existing earn-out right to advance it ahead of 5 April 2008 will prejudice an original clearance. There were some expressions made that they won't take this point, but no promises were made.
- 15 There is no current intention to introduce avoidance rules to prevent converting income into capital, but this may come in due course.
- 16 Draft legislation is likely to be available around 13 December, although this may slip by a couple of days. Further, at the CBI conference held on 27 November, the Chancellor stated that legislation could be expected in the next three weeks.
- 17 There was a comment that "the CGT part of the domicile legislation" will be delayed until the new year because "it is more complex to draft than at first thought". This comment can be taken either way, but in context it gave some cause for optimism that they realise the reform is going to be a nightmare, so they aren't going to make any premature announcements on it which the politicians would then be committed to. So, while the delay is annoying, if we get more sensible legislation as a result then this should be welcomed.

Once the draft legislation is available in mid-December, much more will be known about the proposed changes. At that point, individual circumstances can likely be evaluated and decisions made about any steps that will need to be taken prior to 6 April 2008 when the new CGT regime is likely to come into effect.

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