

capital gains

relevant to ACCA Qualification Paper F6 (UK)

capital gains: in context

■ This article is relevant to candidates sitting Paper F6 (UK) in either June or December 2008, and is based on tax legislation as it applies to 2007–08 (Finance Act 2007).

Question 3 of Paper F6 will focus on capital gains in either a personal or a corporate context.

PERSONAL CAPITAL GAINS

Scope of capital gains tax

Capital gains tax is charged when there is a chargeable disposal of a chargeable asset by a chargeable person.

Remember that a chargeable disposal includes part disposals and the gift of assets. All forms of property are chargeable assets unless exempted. The most important exempt assets (as far as Paper F6 is concerned) are certain chattels (see later) and motor cars.

EXAMPLE 1

Explain when a person will be treated as resident or ordinarily resident in the UK for a particular tax year, and state how a person's residence status establishes whether or not they are liable for capital gains tax:

- A person will be resident in the UK during a tax year if they are present in the UK for 183 days or more.
- A person will also be treated as resident if they visit the UK regularly, with visits averaging 91 days or more per tax year over a period of four or more consecutive tax years.
- Ordinary residence is not precisely defined, but a person will normally be ordinarily resident in the UK if this is where they habitually reside.
- A person is liable to capital gains tax on the disposal of assets during any tax year in which they are either resident or ordinarily resident in the UK.

Basic computation

Remember that individuals only receive the indexation allowance up to April 1998. You will not, however, be expected to calculate indexation factors for individuals. Where relevant, a question will give you either the indexation factor, the amount of indexation, or the figure given for the cost of an asset will already take account of indexation.

EXAMPLE 2

Andy sold a factory on 15 February 2008 for £320,000. The factory had been purchased on 24 January 1990 for £164,000, and had been extended at a cost of £37,000 during March 2000. During May 2002, the roof of the factory was replaced at a cost of £24,000 following a fire.

Andy incurred legal fees of £3,600 in connection with the purchase of the factory, and legal fees of £6,200 in connection with the disposal.

The indexation factor from January 1990 to April 1998 is 0.360.

Andy's chargeable gain (before taper relief) in respect of the factory is as follows:

	£	£
Disposal proceeds		320,000
Incidental costs of disposal		<u>(6,200)</u>
		313,800
Cost	164,000	
Incidental costs of acquisition	<u>3,600</u>	
	167,600	
Enhancement expenditure	<u>37,000</u>	
		<u>(204,600)</u>
		109,200
Indexation – 167,600 x 0.360		<u>(60,336)</u>
		<u>48,864</u>

- The indexation allowance is calculated on the original cost plus the incidental costs of acquisition.
- The factory extension is enhancement expenditure as it has added to the value of the factory.
- The replacement of the roof is not enhancement expenditure, being in the nature of a repair.

Taper relief

For disposals after 5 April 1998, taper relief may be available. The relief is more generous for business assets than for non-business assets. The percentage of the gain chargeable is as follows:

Complete years after 5 April 1998 for which asset is held	Percentage of gains chargeable after relief	
	<i>Business assets</i>	<i>Non-business assets</i>
1	50%	100%
2	25%	100%
3	25%	95%
4	25%	90%
5	25%	85%
6	25%	80%
7	25%	75%
8	25%	70%
9	25%	65%
10	25%	60%

A non-business asset acquired before 17 March 1998 qualifies for an

addition of one year to the period for which it is held after 5 April 1998. Therefore, for disposals of non-business assets during 2007–08, taper relief is based on 10 complete years of ownership if the asset was owned prior to 17 March 1998. Only 60% of the gain will be chargeable.

It is obviously important that you know the distinction between a business asset and a non-business asset. The most relevant types of business asset are as follows:

- assets used for trade purposes by a sole trader
- shares in unquoted trading companies
- shares in quoted trading companies where an individual either has a 5% shareholding or is an employee of the company.

EXAMPLE 3

Bia has been in business as a sole trader since 1 May 2000. On 28 February 2008, she sold the following assets:

- Goodwill for £50,000. The goodwill had been built up since 1 May 2000, and had a nil cost.
- A freehold office building for £130,000. The office building was purchased on 1 July 2006 for £110,000, and was always used by Bia for business purposes.
- A freehold warehouse for £140,000. The warehouse was purchased on 1 May 2000 for £100,000, and was never used by Bia for business purposes.
- A motor car for £25,000. The motor car was purchased on 1 November 2002 for £23,500, and was always used by Bia for business purposes.

Bia's taxable gains for the tax year 2007–08 are as follows:

	£	Gain £	Taper %	Tapered gain £
Goodwill				
Disposal proceeds	50,000			
Cost	(Nil)			
		50,000	25%	12,500
Office building				
Disposal proceeds	130,000			
Cost	(110,000)			
		20,000	50%	10,000
Warehouse				
Disposal proceeds	140,000			
Cost	(100,000)			
		40,000	75%	30,000
				52,500
Annual exemption				(9,200)
				<u>43,300</u>

- Goodwill is a business asset, and taper relief is based on seven complete years of ownership.
- The office building is a business asset, and taper relief is based on one complete year of ownership.
- The warehouse is a non-business asset, and taper relief is based on seven complete years of ownership.
- Motor cars are exempt from capital gains tax.

Rate of capital gains tax

An individual's capital gains are taxed as if they were savings income, but gains are taxed as the top slice of the taxpayer's income. Therefore, the rate of capital gains tax is 10%, 20% or 40% depending on whether the individual pays income tax at the starting rate, the basic rate, or the higher rate. Capital gains tax is collected as part of the self-assessment system, and is due for payment in one amount on 31 January following the tax year. Payments on account are not required in respect of capital gains tax.

EXAMPLE 4

Continuing with **Example 3**, Bia's taxable income for the tax year 2007–08 is £20,000.

Her capital gains tax liability is as follows:

	£
14,600 (34,600 - 20,000) at 20%	2,920
28,700 (43,300 - 14,600) at 40%	<u>11,480</u>
	<u>14,400</u>

- Bia's capital gains tax liability will be due on 31 January 2009.

Common mistakes

There are a number of common mistakes that you should avoid when dealing with capital gains tax:

- Do not treat an unincorporated business as a separate entity for capital gains tax purposes. When a business is disposed of, you should deal with each asset separately.
- Do not forget to deduct the annual exemption.
- Do not deduct the personal allowance from the figure for taxable income which is usually given if you are expected to calculate the capital gains tax liability.
- Do not use the basic rate of 22% instead of the savings rate of 20%.

Taper relief and capital losses

Taper relief is computed after deducting any current year capital losses. For this purpose, capital losses are set against capital gains on the most beneficial basis. Therefore a capital loss should be set against the capital gains qualifying for the least amount of taper relief.

EXAMPLE 5

During the tax year 2007–08, Claude had the following capital gains and losses:

- A capital gain of £12,000 on a business asset.
- A capital gain of £14,000 on a non-business asset.
- A capital loss of £8,000.

The assets were all owned for two complete years prior to the date of their disposal.

	£	Gain £	Taper %	Tapered gain £
Business asset		12,000	25%	3,000
Non-business asset	14,000			
Capital loss	(8,000)			
		6,000	100%	<u>6,000</u>
				<u>9,000</u>

- The capital loss is set off against the non-business asset since this does not qualify for taper relief.

Married couples

Transfers between spouses do not give rise to any gain or loss. The same treatment applies to transfers between same-sex couples in a civil partnership.

EXAMPLE 6

David and Eli Fong are a married couple. They disposed of the following assets during the tax year 2007–08:

- On 10 June 2007, David and Eli sold a house for £380,000. The house had been purchased on 1 December 2004 for £290,000, and has never been occupied as their main residence.
- On 5 August 2007, David transferred his entire shareholding of 20,000 £1 ordinary shares in Gong Ltd, an unquoted trading company, to Eli. On that date, the shares were valued at £64,000. David's shareholding had been purchased on 21 September 2005 for £48,000.
- On 7 October 2007, Eli sold the 20,000 £1 ordinary shares in Gong Ltd that had been transferred to her from David. The sale proceeds were £70,000.

David and Eli are both 40% taxpayers.

Jointly-owned property

The chargeable gain on the house is £90,000 (380,000 - 290,000). David and Eli will each be assessed on £45,000 (90,000 x 50%) of the chargeable gain.

David Fong – capital gains tax liability 2007–08

	Gain £	Taper %	Tapered gain £
House	45,000	100%	45,000
Annual exemption			<u>(9,200)</u>
			<u>35,800</u>
Capital gains tax at 40%			<u>14,320</u>

- The transfer of the 20,000 £1 ordinary shares in Gong Ltd to Eli does not give rise to any gain or loss, because it is a transfer between spouses.

Eli Fong – capital gains tax liability 2007–08

	£	Gain £	Taper %	Tapered gain £
House		45,000	100%	45,000
Ordinary shares in Gong Ltd				
Disposal proceeds	70,000			
Cost	<u>(48,000)</u>			
		22,000	25%	<u>5,500</u>
				50,500
Annual exemption				<u>(9,200)</u>
				<u>41,300</u>
Capital gains tax at 40%				<u>16,520</u>

- David's original cost is used in calculating the capital gain on the disposal of the shares in Gong Ltd.
- The shares in Gong Ltd are a business asset, and taper relief is based on two complete years of ownership. It is the couple's combined period of ownership that is relevant.

Part disposals

When only part of an asset is disposed of, the cost must be apportioned between the part disposed of and the part retained.

EXAMPLE 7

On 16 February 2008, Harry sold three acres of land for £285,000. He had originally purchased four acres of land on 17 July 2006 for £220,000. As at 16 February 2008, the market value of the unsold acre of land was £90,000.

- The cost relating to the three acres of land sold is £167,200 (220,000 x 285,000/375,000 (285,000 + 90,000)).
- The chargeable gain on the land is therefore £117,800 (285,000 - 167,200).

Chattels

Special rules apply to chattels. A chattel is tangible moveable property.

EXAMPLE 8

On 18 April 2007, Ivy sold an antique table for £5,600 and an antique clock for £7,200. The antique table had been purchased on 27 May 2006 for £3,200, and the antique clock had been purchased on 14 June 2006 for £3,700.

- The antique table is exempt from capital gains tax because the gross sale proceeds were less than £6,000.
- The gain on the antique clock is restricted to £2,000 (7,200 - 6,000 = 1,200 x 5/3) as this is less than £3,500 (7,200 - 3,700).

Principal private residences

A gain on the disposal of a principal private residence is exempt where

the owner has occupied the house throughout the whole period of ownership. The final 36 months of ownership are always treated as a period of occupation. The following periods of absence are deemed to be periods of occupation:

- Periods up to a total of three years, for any reason.
- Any periods where the owner is required to live abroad due to their employment.
- Periods up to four years where the owner is required to live elsewhere in the UK due to their employment.

These deemed periods of occupation must normally be preceded and followed by actual periods of occupation.

EXAMPLE 9

On 30 September 2007, Jue sold a house for £381,900. The house had been purchased on 1 October 1987, and its indexed cost is £141,900.

Jue occupied the house as her main residence from the date of purchase until 31 March 1991. The house was then unoccupied between 1 April 1991 and 31 December 1994 due to Jue being required by her employer to work elsewhere in the UK.

From 1 January 1995 until 31 December 2001, Jue again occupied the house as her main residence. The house was then unoccupied until it was sold on 30 September 2007.

The chargeable gain on the house before taper relief is as follows:

	£
Disposal proceeds	381,900
Indexed cost	<u>(141,900)</u>
	240,000
Principal private residence exemption	<u>(207,000)</u>
	<u>33,000</u>

The total period of ownership of the house is 240 months (207 + 33), of which 207 months qualify for exemption as follows:

	Exempt months	Chargeable months
1 October 1987 to 31 March 1991 (occupied)	42	
1 April 1991 to 31 December 1994 (working in UK)	45	
1 January 1995 to 31 December 2001 (occupied)	84	
1 January 2002 to 30 September 2004 (unoccupied)		33
1 October 2004 to 30 September 2007 (final 36 months)	<u>36</u>	
	<u>207</u>	<u>33</u>

The exemption is, therefore, £207,000 (240,000 x 207/240).

Letting relief will extend the principal private residence exemption where a property is let out during a period that does not otherwise qualify for exemption.

EXAMPLE 10

Continuing with **Example 9**, assume that Jue let her house out during those periods when she did not occupy it.

The chargeable gain on the house before taper relief will now be as follows:

	£
Disposal proceeds	381,900
Indexed cost	<u>(141,900)</u>
	240,000
Principal private residence exemption	<u>(207,000)</u>
Letting relief exemption	<u>(33,000)</u>
	<u>Nil</u>

The letting relief exemption is the lowest of:

- £40,000
- £207,000 (the amount of the gain exempt under the principal private residence rules)
- £33,000 (the amount of the non-exempt gain attributable to the period of letting (240,000 x 33/240)).

Shares

The disposal of shares can create a particular problem. This is because the shares disposed of might have been purchased at different times, and it is then difficult to identify exactly which shares have been sold. Because taper relief may be given in respect of disposals made after 5 April 1998, it is necessary to separately identify purchases made after that date.

Disposals of shares are matched with purchases in the following order:

- Shares purchased on the same day as the disposal.
- Shares purchased within the following 30 days.
- Shares purchased after 5 April 1998 (taking the most recent purchase first on a LIFO basis).
- Shares in the 1985 Pool.

The 1985 Pool aggregates all purchases made on or before 5 April 1998. As far as the exam is concerned, you will simply be given a figure for the value of the 1985 Pool as at 5 April 1998.

EXAMPLE 11

Kim has had the following transactions in the shares of Long plc:

1 June 1994	Purchased 3,000 shares for £6,000. The indexed value of the 1985 Pool at 5 April 1998 is £6,900.
30 April 2006	Purchased 1,500 shares for £6,750
15 May 2006	Purchased 500 shares for £2,500
15 February 2008	Sold 4,000 shares for £24,000

The shares in Long plc are not a business asset for the purposes of taper relief. Kim's capital gain for 2007–08 is as follows:

	£	Gain £	Taper %	Tapered gain £
Purchase 15 May 2006				
Disposal proceeds (24,000 x 500/4,000)	3,000			
Cost	<u>(2,500)</u>			
		500	100	500
Purchase 30 April 2006				
Disposal proceeds (24,000 x 1,500/4,000)	9,000			
Cost	<u>(6,750)</u>			
		2,250	100	2,250
1985 Pool				
Disposal proceeds (24,000 x 2,000/4,000)	12,000			
Cost (6,900 x 2,000/3,000)	<u>(4,600)</u>			
		7,400	60	<u>4,440</u> <u>7,190</u>

- Taper relief is not available in respect of the shares acquired on 30 April 2006 or 15 May 2006 as they were not held for three complete years.
- The shares included in the 1985 Pool were owned prior to 17 March 1998, so taper relief is based on 10 complete years of ownership.

The reason that disposals are matched with shares purchased within the following 30 days is to prevent a practice known as bed and breakfasting. A person might sell shares at the close of business one day and then buy them back at the opening of business the next day. Previously, a gain or loss could thus be established without a genuine disposal being made.

The 30-day matching rule makes bed and breakfasting much more difficult, since the subsequent purchase cannot take place within 30 days.

EXAMPLE 12

Martin purchased 1,000 shares in Nok plc on 5 May 2007 for £10,000. The shares have fallen in value so he would like to establish a capital loss. Therefore the shares were sold on 2 December 2007 for £2,000, and purchased back on 10 December 2007 for £1,900.

Martin's transactions are caught by the 30-day matching rule. The disposal on 2 December 2007 will be matched with the purchase on 10 December 2007, and so for 2007–08 he will have a capital gain of £100 (2,000 - 1,900).

With individuals, it might be necessary to establish a market value figure where the shares are disposed of by way of a gift, rather than being sold.

EXAMPLE 13

Olive made a gift of her entire shareholding of 10,000 £1 ordinary shares in Pink plc to her daughter. On the date of the gift, the shares were quoted at £5.10–£5.18, with recorded bargains of £5.00, £5.15 and £5.22.

- The shares in Pink plc are valued at the lower of the quarter up price ($£5.10 + \frac{1}{4} (£5.18 - £5.10) = £5.12$), and at the average of the day's highest and lowest bargains ($(£5.00 + £5.22)/2 = £5.11$).
- The deemed proceeds figure is therefore £51,100 (10,000 x 5.11).

With a bonus issue, there is no additional cost involved. The only thing that changes is the number of shares held.

EXAMPLE 14

On 22 January 2008, Quinn sold 30,000 £1 ordinary shares in Rune plc for £140,000. Quinn had purchased 40,000 shares in Rune plc on 9 February 2007 for £96,000. On 3 April 2007, Rune plc made a 1 for 2 bonus issue.

	£
Disposal proceeds	140,000
Cost	<u>(48,000)</u>
	<u>92,000</u>

- Quinn was issued with 20,000 (40,000 x 1/2) new shares as a result of the bonus issue.
- The cost of the shares sold is therefore £48,000 (96,000 x 30,000/(40,000 + 20,000)).

With a rights issue the new shares are paid for, and so the cost figure will have to be adjusted.

EXAMPLE 15

On 22 January 2008, Sue sold 30,000 £1 ordinary shares in Tin plc for £140,000. Sue had purchased 40,000 shares in Tin plc on 9 February 2004 for £100,000. On 3 May 2006, Tin plc made a 1 for 2 rights issue. Sue took up her allocation under the rights issue in full, paying £3.00 for each new share issued.

	£	Gain £	Taper %	Tapered gain £
Disposal proceeds	140,000			
Cost	<u>(80,000)</u>			
		60,000	95	<u>57,000</u>

- Sue was issued with 20,000 (40,000 x 1/2) new shares under the rights issue at a cost of £60,000 (20,000 x £3.00).
- The cost of the shares sold is therefore £80,000 (100,000 + 60,000 = 160,000 x 30,000/(40,000 + 20,000)).
- Taper relief is based on three complete years of ownership. The rights issue is treated as an enhancement of the original shareholding. As such, it is ignored for taper relief purposes.

A paper-for-paper takeover or reorganisation is not a chargeable disposal. The new shares simply take the place of the original shares, and are deemed to have been purchased at the same time and for the same cost. If more than one class of new share is acquired as a result of a takeover, the original cost is apportioned according to the market values of the new shares immediately after the takeover.

EXAMPLE 16

On 28 March 2008, Ula sold her entire holding of £1 ordinary shares in Vine plc for £55,000. Ula had originally purchased 10,000 shares in Vine plc on 5 May 2007 for £14,000. On 7 August 2005, Vine plc had a reorganisation whereby each £1 ordinary share was exchanged for two new £1 ordinary shares and one £1 preference share. Immediately after the reorganisation, each £1 ordinary share in Vine plc was quoted at £2.50 and each £1 preference share was quoted at £1.25.

	£
Disposal proceeds	55,000
Cost	<u>11,200</u>
	<u>43,800</u>

- On the reorganisation, Ula received new ordinary shares valued at £50,000 (2 x 10,000 x £2.50) and preference shares valued at £12,500 (10,000 x £1.25).
- The cost attributable to the ordinary shares is £11,200 (14,000 x 50,000/(50,000 + 12,500))

Rollover relief

Rollover relief allows a capital gain to be deferred (rolled over) where the disposal proceeds of the old asset are reinvested in a new asset. The deferral is achieved by deducting the capital gain from the cost of the new asset.

To qualify for rollover relief, both the old asset and the new asset must be qualifying assets. The most relevant types of qualifying asset are as follows:

- land and buildings
- fixed plant and machinery
- goodwill.

It is not necessary for the old asset and the new asset to be in the same category.

EXAMPLE 17

What are the conditions that must be met so that rollover relief can be claimed?

- The reinvestment must take place between one year before and three years after the date of disposal.
- The old and new assets must both be qualifying assets and must be used for business purposes.
- The new asset must be brought into business use at the time that it is acquired.

Where the disposal proceeds of the old asset are not fully reinvested in the new asset, the amount not reinvested reduces the amount of capital gain that can be rolled over. Therefore, if the amount not reinvested is greater than the capital gain no rollover relief is available.

Where the new asset is a depreciating asset, then the gain does not reduce the cost of the new asset but is instead held over. A depreciating asset is an asset with a predictable life of less than 60 years. The only types of depreciating asset that you need to be aware of are fixed plant and machinery and short leaseholds.

EXAMPLE 18

Willow sold a factory on 15 February 2008 for £320,000, and this resulted in a capital gain of £85,000. She is considering the following alternative ways of reinvesting the proceeds from the sale of her factory (note – the reinvestment will take place during May 2008):

- A freehold warehouse can be purchased for £340,000.
- A freehold office building can be purchased for £275,000.
- A leasehold factory on a 40-year lease can be acquired for a premium of £350,000.

Warehouse

- The sale proceeds are fully reinvested, and so the whole of the gain can be rolled over.
- The base cost of the warehouse will be £255,000 (340,000 - 85,000).

Office building

- The sale proceeds are not fully reinvested, and so £45,000 (320,000 - 275,000) of the capital gain cannot be rolled over.
- The base cost of the office building will be £235,000 (275,000 - (85,000 - 45,000)).

Factory

- The sale proceeds are fully reinvested, and so the whole of the gain can be held over.
- The factory is a depreciating asset, and so the base cost of the factory is not adjusted.
- The gain is held over until the earlier of May 2018 (10 years from the date of acquisition) or the date that the factory is sold.

Remember that a claim for rollover relief will mean that any entitlement to taper relief is lost in respect of the rolled over gain.

When the new asset is subsequently sold, only the period of ownership of that new asset counts when deciding how much taper relief is due.

If the asset disposed of was not used entirely for business purposes, then the gain relating to the non-business proportion does not qualify for rollover relief.

EXAMPLE 19

Xia sold a freehold factory on 8 November 2007 for £146,000, and this resulted in a capital gain of £74,000. The factory had been purchased on 15 January 2005. 75% of the factory had been used for business purposes by Xia as a sole trader, but the other 25% was never used for business purposes. Xia purchased a new freehold factory on 10 November 2007 for £156,000.

	£
Capital gain	74,000
Rollover relief (74,000 - 18,500)	<u>(55,500)</u>
	<u>18,500</u>

- The proportion of the gain relating to non-business use is £18,500 (74,000 x 25%), and this amount does not qualify for rollover relief.
- As the sale proceeds are fully reinvested, the balance of the gain can be rolled over.
- The base cost of the new factory is £100,500 (156,000 - 55,500).
- The figure chargeable relates to a non-business asset. Taper relief is not available as the factory has been owned for less than three years.

Holdover relief

Holdover relief allows a capital gain to be deferred (held over) when a gift is made of a qualifying business asset. The deferral is achieved by deducting the capital gain of the donor who has made the gift from the base cost of the donee who has received the gift.

Holdover relief is also available when a sale is made at less than market value. In this case, there will be an immediate charge to capital gains tax where sale proceeds exceed the original cost of the asset.

The most relevant types of qualifying business asset are as follows:

- Assets used for trade purposes by a sole trader.
- Shares in a personal company (where the individual has at least a 5% shareholding).
- Shares in unquoted trading companies.

Remember, when a gift is made between family members, the market value of an asset is used rather than the actual proceeds as family members are connected persons.

EXAMPLE 20

On 15 April 2007, Yui sold 10,000 £1 ordinary shares (a 30% shareholding) in Zone Ltd, an unquoted trading company, to her daughter for £75,000. The market value of the shares on that date was £110,000. The shareholding was purchased on 10 July 2006 for £38,000. Yui and her daughter have elected to hold over the gain as a gift of a business asset.

	£
Deemed proceeds	110,000
Cost	<u>(38,000)</u>
	72,000
Gift relief (72,000 - 37,000)	<u>(35,000)</u>
	<u>37,000</u>

- Yui and her daughter are connected persons, and therefore the market value of the shares sold is used.
- The consideration paid for the shares exceeds the allowable cost by £37,000 (75,000 - 38,000). This amount is immediately chargeable to capital gains tax.

Where shares in a personal company are concerned, holdover relief will be restricted if the company has chargeable non-business assets.

EXAMPLE 21

On 5 October 2007, Apple made a gift of her entire holding of 20,000 £1 ordinary shares (a 100% holding) in Black Ltd, an unquoted trading company, to her daughter. The market value of the shares on that date was £200,000. The shares had been purchased on 1 January 2007 for £140,000. On 5 October 2007, the market value of Black Ltd's chargeable assets was £150,000, of which £120,000 was in respect of chargeable business assets. Apple and her daughter have elected to hold over the gain as a gift of a business asset.

	£
Deemed proceeds	200,000
Cost	<u>(140,000)</u>
	60,000
Gift relief	<u>(48,000)</u>
	<u>12,000</u>

- Gift relief is restricted to £48,000 (60,000 x 120,000/150,000), being the proportion of chargeable assets to chargeable business assets.

A claim for holdover relief will mean that the donor loses any entitlement to taper relief in respect of the held over gain. When the donee subsequently sells the asset, only their period of ownership counts in deciding how much taper relief is due.

The transfer of a business to a limited company

Rollover relief is available when an unincorporated business is incorporated. For relief to be available, all the assets of the unincorporated business must be transferred to the new limited company in exchange for a consideration that must be wholly or partly in the form of shares.

The deferral is achieved by deducting the capital gains arising on the disposal of the assets of the unincorporated business from the value of the shares received from the new limited company.

Where some of the consideration is in the form of cash or a loan, then that proportion of the capital gains cannot be rolled over.

EXAMPLE 22

On 8 April 2007, Chloe incorporated a wholesale business that she had run as a sole trader since 1 March 2005. The market value of the business on 8 April 2007 was £250,000. All of the business assets were transferred to a new limited company, with the consideration consisting of 200,000 £1 ordinary shares valued at £200,000, and

£50,000 in cash. The only chargeable asset of the business was goodwill, and this was valued at £100,000 on 8 April 2007. The goodwill had a nil cost.

	£	Gain £	Taper %	Tapered gain £
Disposal proceeds	100,000			
Cost	(Nil)			
	<u>100,000</u>			
Rollover relief (100,000 - 20,000)	<u>(80,000)</u>			
		20,000	25%	<u>5,000</u>

- As the proportion of the gain relating to the cash consideration cannot be rolled over, £20,000 (100,000 x 50,000/250,000) of the capital gain is immediately chargeable to capital gains tax.
- Taper relief is based on two complete years of ownership.

A claim for rollover relief on incorporation will mean that any entitlement to taper relief is lost in respect of the gain rolled over. When the new shares are subsequently sold, only their period of ownership counts in deciding how much taper relief is due.

The loss or destruction of an asset

If an asset is lost or destroyed then the receipt of insurance monies is treated as a normal disposal. However, rollover relief is available if the insurance monies are used to purchase a replacement asset within a period of 12 months.

EXAMPLE 23

On 20 May 2007, an antique table owned by Dwight was destroyed in a fire. The antique table had been purchased on 23 November 2006 for £50,000. Dwight received insurance proceeds of £74,000 on 6 August 2007, and on 18 August 2007 he paid £75,400 for a replacement antique table.

- The insurance proceeds of £74,000 received by Dwight have been fully reinvested in a replacement antique table.
- The disposal is therefore on a 'no gain no loss' basis, with the capital gain of £24,000 (insurance proceeds of £74,000 less original cost of £50,000) being set against the cost of the replacement antique table.

CORPORATE CAPITAL GAINS

Overview

You have seen how individuals are subject to capital gains tax. Although there are a lot of similarities in the way in which the capital gains of a limited company are taxed, there are also some very important differences, namely:

- A limited company's capital gains form part of the profits chargeable to corporation tax. They are not taxed separately.
- The annual exemption is not available.

- The indexation allowance is given up to the date of disposal when calculating capital gains for a limited company. Taper relief is not available to limited companies.
- Limited companies can only benefit from rollover relief. They cannot benefit from holdover relief for the gift of business assets, or from rollover relief upon incorporation. For companies, remember that rollover relief is applied after taking account of indexation allowance.

Basic computation

The basic computation for a limited company is virtually the same as for an individual. However, as you may be expected to calculate the indexation allowance, remember the following:

- Limited companies receive the indexation allowance up to the month of disposal.
- The indexation factor is normally rounded to three decimal places.
- The indexation allowance cannot be used to create or increase a capital loss.

EXAMPLE 24

Even Ltd sold a factory on 15 February 2008 for £320,000. The factory had been purchased on 24 October 1995 for £164,000, and had been extended at a cost of £37,000 during March 1997.

Even Ltd incurred legal fees of £3,600 in connection with the purchase of the factory, and legal fees of £6,200 in connection with the disposal. Retail price indices (RPIs) are as follows:

October 1995	149.8
March 1997	155.4
February 2008	208.0

	£	£
Disposal proceeds		320,000
Incidental costs of disposal		<u>(6,200)</u>
		313,800
Cost	164,000	
Incidental costs of acquisition	<u>3,600</u>	
	167,600	
Enhancement expenditure	<u>37,000</u>	
		<u>(204,600)</u>
		109,200
Indexation		
	- Cost 167,600 x 0.389	65,196
	- Enhancement 37,000 x 0.338	<u>12,506</u>
		<u>(77,702)</u>
		31,498

- The indexation factor for the cost is 0.389 (208.0 - 149.8)/149.8, and for the enhancement expenditure it is 0.338 (208.0 - 155.4)/155.4.

When a limited company has a capital loss, it is first set off against any capital gains arising in the same accounting period. Any remaining

capital loss is then carried forward and set off against the first available capital gains of future accounting periods.

Although capital gains are included as part of a company's profits chargeable to corporation tax, capital losses are never set off against other income.

EXAMPLE 25

Fine Ltd has the following results:

	Year ended 31 March 2007	Year ended 31 March 2008
	£	£
Trading profit/(loss)	56,000	(17,000)
Property business income	4,000	10,000
Capital gain/(loss)	(8,000)	85,000

The corporation tax liability of Fine Ltd for the years ended 31 March 2007 and 2008 is as follows:

	Year ended 31 March 2007	Year ended 31 March 2008
	£	£
Trading profit	56,000	-
Property business income	4,000	10,000
Capital gain	-	77,000
	<u>60,000</u>	<u>87,000</u>
Loss relief	-	(17,000)
Profits chargeable to corporation tax	<u>60,000</u>	<u>70,000</u>
Corporation tax at 19%	11,400	
Corporation tax at 20%	-	<u>14,000</u>

- The capital loss for the year ended 31 March 2007 is carried forward, and so the capital gain for the year ended 31 March 2008 is £77,000 (85,000 - 8,000).

Shares

For limited companies, disposals of shares are matched with purchases in the following order:

- Shares purchased on the same day as the disposal.
- Shares purchased during the nine days prior to the disposal.
- Shares in the 1985 Pool.

When calculating indexation allowances for the 1985 Pool, the indexation fraction is not rounded to three decimal places.

EXAMPLE 26

On 15 June 2007, Gong Ltd sold 70,000 £1 ordinary shares in Heavy plc for £275,000. Gong Ltd had originally purchased 40,000 shares in Heavy plc on 10 June 1995 for £110,000, and purchased a further 60,000 shares on 20 August 1999 for £180,000.

Retail price indices (RPIs) are as follows:

Capital gains tax is charged when there is a chargeable disposal of a chargeable asset by a chargeable person. There is a lot to learn and the differences in the treatment of limited companies and individuals do not make this task any easier. It is important that you know how to lay out a basic computation for both an individual and a limited company, calculate taper relief, and apply the three different reliefs that are available.

June 1995	149.8
August 1999	165.5
June 2007	205.0

Capital gain

Disposal proceeds	275,000
Cost	<u>(203,000)</u>
	72,000
Indexation (261,446 - 203,000)	<u>(58,446)</u>
	<u>13,554</u>

1985 Pool

	Number	Cost £	Indexed cost £
Purchase June 1995	40,000	110,000	110,000
Indexation to August 1999			<u>11,529</u>
110,000 x (165.5 - 149.8)/149.8			<u>121,529</u>
Purchase August 1999	<u>60,000</u>	<u>180,000</u>	<u>180,000</u>
	100,000	290,000	301,529
Indexation to June 2007			<u>71,966</u>
301,529 x (205.0 - 165.5)/165.5			<u>373,495</u>
Disposal June 2007			
Cost x 70,000/100,000	<u>(70,000)</u>	<u>(203,000)</u>	<u>(261,446)</u>
Balance carried forward	<u>30,000</u>	<u>87,000</u>	<u>112,049</u>

CONCLUSION

There is quite a lot to learn with regards to capital gains, and the differences in the treatment of limited companies and individuals do not make this task any easier. It is particularly important that you know how to do the following: lay out a basic computation for both an individual and a limited company; calculate taper relief; and apply the three different reliefs that are available. ■

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