Capital Gains Tax

Many investors think that Capital Gains Tax (CGT) only affects the wealthiest investors, but it is easy to be caught by this tax particularly if you hold investments for many years. Here we look at some simple tax-planning steps you can take to reduce your CGT liabilities.

Capital Gains Tax (CGT) can be easily forgotten until it is too late. Most of us pay income tax on salaries, dividends and interest at regular intervals, but are only hit by CGT intermittently when we need to sell an investment.

For investments made many years ago, it can be quite a shock to realise how large a CGT liability has quietly built up. Any long-term investor who steadily buys and holds shares or funds for a couple of decades could suddenly find themselves owing significant amounts when they need to sell their holdings in a single tax year.

The good news is that CGT liabilities can be reduced for many of us, if we simply use the tax allowances to which we're entitled. The "bad news" is that this can require careful management of our CGT position throughout our investing lives.

In this article, we'll look at a number of simple tax-planning steps that you may wish to consider every tax year, in order to minimise your eventual CGT bill. However, please bear in mind that Hamblin Martin Financial does not offer tax advice – you should always seek independent advice on your tax affairs from a qualified third party.

Use your annual allowance

Every taxpayer has an annual CGT allowance, known as the Annual Exempt Amount, which stands at £11,100 in 2015/16. The total of capital gains you realise in a tax year up to this allowance are not subject to tax. However, if you are a resident but not domiciled in the UK and you pay tax on a remittance basis, then this allowance may not be available to you.

If you leave this allowance unused for any given tax year then you will lose it forever – unused allowances cannot be rolled over to the next tax year. So, depending on your investment strategy, it may make sense to sell some assets before the end of each tax year, in order to realise a capital gain up to the allowance limit. It's important, however, that you don't lose sight of your overall investment objectives.

You do not need to sell these assets for good. However, if you plan to repurchase them, you may want to take care when you do so. In the past, it was possible to sell shares one day and then buy them back the next in order to create a disposal for CGT purposes – a technique known as "bed and breakfasting".
These days, however, HMRC will draw a taxable connection between such transactions, using a process known as "share matching". These rules mean that if you repurchase the same shares within 30 days of disposal, the disposal may not give rise to a gain or loss. Some investors therefore choose to wait for more than 30 days before repurchasing investments they have just sold.

Of course, by doing this you run the risk of the market moving against you during the 30 days (for example, the shares you sold may rise in price). So you need to weigh up whether the tax savings you could make by using the technique are worth the risk.

In some situations, you may be able to reduce the risks involved if you can find a second investment whose characteristics are very similar to the first. This way, you may be able to sell the first investment and then immediately buy the second – registering a disposal for CGT purposes without having to wait for 30 days to rebuild your portfolio. For example, if you sold an ETF tracking the FTSE 100, you could purchase a different ETF that tracked the same index immediately and the trades would not be matched for CGT purposes.

You should note, however, that even ETFs designed to track the same assets can have different risks associated with them. For example, a fully replicated ETF will buy every share in an index, but a synthetic ETF will not hold any shares at all. Instead, synthetic ETFs purchase derivatives known as “swaps” – usually from an investment bank – that promise to pay the same return as the index they are tracking. However, if the seller of the swap gets into trouble, it may not be able to meet its obligations, so investors in the ETF (the buyer) could lose out. This is known as “counterparty risk”.
You should also take account of any costs in selling and buying back your investments, when assessing the benefit of realising gains.

Use your spouse’s allowance

Transfers between married couples are not treated as sales and are not subject to CGT. So, if your spouse has not used part or all of their CGT allowance in a given tax year, you could consider transferring investments to him or her. Please note, however, that there are strict conditions attached to this and you may wish to consult your tax adviser accordingly.

This technique may be especially useful if your spouse rarely or never needs to use their CGT allowance. If you both sell some investments before the end of the tax year, you can both realise gains up to the limit of your individual allowances, without paying CGT on the proceeds.

In other words, you can effectively double your CGT allowance every year with your spouse’s help, if you are happy to make an outright gift of the investments in question. These actions represent the transfer of ownership to your spouse, and so you lose control of the assets, and your spouse can dispose of them as they wish.

Use your ISA and SIPP

Gains on investments held in an ISA or SIPP are not subject to CGT, so it makes sense to try to use these tax wrappers to shelter your portfolio where possible.

The bed-and-breakfast rules do not affect transactions where the repurchase is done inside an ISA or SIPP.

So if you already have a taxable portfolio with large unrealised capital gains, you could consider using your annual CGT allowance to realise some of these, then buy the shares back inside the tax wrapper immediately. Doing this is often known as “Bed & ISA” or “Bed & SIPP” respectively. But you may still be out of the market for a period while the contributions to the ISA and SIPP are processed and remember that the value in the investments purchased in a SIPP is then not available to you until you are at least 55 (and rising to 57 from 2028).

Use losses to your advantage

You can offset capital gains on successful investments with losses from ones that did not work out so well. So if you need to realise gains that are larger than your allowance in a given tax year, you could also consider taking some losses at the same time to reduce the net amount of gains that will be subject to tax.

If you have few or no gains to take in the tax year and you still need to take some losses, remember that those losses can be carried forward to offset gains in future tax years. The loss needs to be notified to HMRC within four years of the year in which it occurred, but can then be rolled forwarded indefinitely. Also, in the same way as gains in a tax wrapper are not taxable, any losses realised in an ISA or SIPP cannot be offset against capital gains made outside the wrapper.

Keep it simple

There are a number of other ways to reduce your tax bill that can be effective, such as Venture Capital Trusts and Enterprise Investment Schemes. These give you tax relief in return for investing in qualifying unquoted trading companies.

Both can be useful for sophisticated investors, but you should bear in mind that they come with increased risks. The generous tax breaks are needed to encourage people to invest in companies where the chances of losing some or all of their investment are much higher.

The simpler steps listed above will be sufficient for many investors, allowing them to reduce their potential CGT liabilities with little or no added risk. If you are considering more complicated or riskier tax-planning measures, you should think about taking independent financial advice first. Remember that whilst you may want your investments to be tax-efficient, you should not let that dictate your investment strategy. You can still lose money investing just as you do when paying tax.

Please be aware that the level and basis of tax can change. These changes may affect both future opportunities and your existing arrangements. The value of tax relief and tax-efficient planning depends on your personal circumstances.

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