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Wealth preservation

How to minimise a Capital Gains Tax bill

The rules around Capital Gains Tax (CGT) are complex and they differ depending on your financial situation. It's a complicated tax and, as a result, some people may get confused about how much they should expect to pay.

WHAT IS CAPITAL GAINS TAX?

Capital Gains Tax is a tax payable on the profits (or 'capital gains') you make from selling certain assets. These assets include some property, items of value such as art, jewellery or collectables, company shares or other investments, and businesses or business assets.

HOW MUCH IS CAPITAL GAINS TAX?

The rate of CGT you pay can vary, which sometimes catches people out.

Firstly, you have a CGT tax-free allowance (of £12,300 in the current tax year, though this can change). The UK tax year starts on 6 April each year and ends on 5 April the following year. If you make more than this in capital gains, you'll be charged a different rate depending on the asset that you sold and your Income Tax band.

Higher rate and additional rate taxpayers pay 20% CGT, or an increased 28% when selling residential property (other than a main residence, the home that you live in).

Basic rate taxpayers pay 10% CGT, increasing to 18% for residential property, unless their total capital gains (minus the 2021/22 personal allowance of £12,570), when added to their taxable income, would place them in a higher tax bracket. If this is the case, they will pay the rates above.

HOW CAN YOU PROTECT YOUR ASSETS FROM CAPITAL GAINS TAX?

Some assets can be sold free from CGT, including your main residence (in most cases, though CGT can sometimes apply), and personal belongings worth less than £6,000.

In some cases, you can protect your assets from CGT by keeping them within an Individual Savings Account (ISA) wrapper. Assets that can be held in an ISA include bonds, company shares and investment funds. Any returns generated by these investments are free from Income Tax and CGT as long as they are held in an ISA.

However, you can only contribute up to £20,000 into an ISA each tax year, and once you have used your ISA allowance any further investments will not be protected.

HOW ELSE CAN YOU MINIMISE YOUR CAPITAL GAINS TAX BILL?

For assets that can't be sold free from CGT and can't be held within an ISA, there are other methods you could potentially use to minimise your CGT bill.

USE YOUR FULL TAX-FREE CAPITAL GAINS TAX ALLOWANCE

If you have any unused tax-free CGT allowance in one tax year (£12,300 per tax year 2021/22 until 2025/26),

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it might be a good opportunity for you to realise some investment gains. If you can spread your gains over several years, you could choose to take only up to the tax-free CGT allowance in each year. The CGT allowance is reset every year and cannot be carried forward.

TRANSFER ASSETS TO YOUR PARTNER

If appropriate, you could transfer assets to a spouse or registered civil partner without paying CGT and share assets between the two of you to take advantage of both of your CGT allowances. If you have exceeded both allowances, it might make sense for any partner who is in the lower tax bracket to realise further gains, as the rate of CGT they pay may be lower. Any transfers must be genuine and outright gifts for this to be effective.

OFFSET LOSSES

If you have sold any assets at a loss in the current tax year, you can offset this loss against other gains you have made. As long as you register a loss with HM Revenue & Customs, within the following four tax years, you can continue to offset it against any future gains indefinitely.

SELL AND BUY BACK WITHOUT WAITING 30 DAYS

You could sell an asset and then your spouse immediately buys it back, which is known as the 'bed and spouse' technique. You could sell the assets, before immediately buying them back within an ISA and protecting them in an ISA (the 'bed and ISA' technique). There is also the 'bed and SIPP' method. This method sees people saving for retirement sell their assets, before buying them back within their Self-Invested Personal Pension (SIPP). These are ways of making use of your CGT exemption – if you wanted to sell and repurchase the same asset yourself in order to realise the gain there has to be a gap of 30 days between sale and repurchase.

DEDUCT COSTS

Any costs that you have incurred in the process of buying or selling an asset can be deducted from the profit you have made when calculating the CGT due. This could include auction fees, solicitor's fees, stamp duty, et cetera.

REDUCE YOUR TAXABLE INCOME

Your rate of Capital Gains Tax is based on your income. This means that you could lower your bill by lowering the Income Tax that you're liable to pay. You could contribute more of your income into your pension pot, helping to avoid this money being taxed, or by making charitable donations.

USE TAX-EFFICIENT INVESTMENT VEHICLES

We've already discussed Stocks & Shares ISAs, but another investment vehicle you could use to protect your wealth from CGT is a pension. Other investment vehicles are also available to help you manage Income Tax, CGT and Inheritance Tax. However, due to the complex rules and variety of options available, you should always obtain professional financial advice before investing. ■

LET'S TALK TAX

If you'd like to explore or have any questions about how to reduce a potential CGT bill, please get in touch to discuss your specific circumstances and review the options available to you.