

Implications of the Pre-Budget Report

Nick Braun looks at the influence of the proposed changes to the Capital Gains Tax in 2008's Pre-Budget Tax Review

The October 2007 Pre-Budget Report contained massive changes to capital gains tax. The proposed changes include:

- A flat 18% tax rate
- The abolition of taper relief, and
- The abolition of indexation relief.

The new rules will apply to all property sales taking place from 6th April 2008. It doesn't matter whether you bought your property before or after that date.

How certain are these changes?

At this stage, it's important to stress that these are just proposals. They probably won't make it onto the statute books until July or August 2008.

Various people have been lobbying the Chancellor of the Exchequer to scrap the reforms, with the loudest complaints coming from business groups because they're the ones most adversely affected.

A complete U-turn seems unlikely but the Government may give some ground to business owners, especially those who are thinking about retiring.

In general we would suggest that most

of the proposals will probably become law but there will be a few refinements.

Who wins, who loses?

For many property investors capital gains tax will become a lot less complicated and a lot less expensive. As always when it comes to tax, however, there will be winners and losers.

The biggest losers are commercial property investors who own properties that currently qualify for full 'business asset taper relief'. These are usually properties let to 'unquoted' tenants – sole traders or partnerships, as well as companies not listed on the stock market.

Three-quarters of these profits are currently tax-free. If you pay 40% tax on just one quarter of your profits that means your overall tax rate is only 10%. And if you're a basic-rate taxpayer your overall rate is only 5%. So, some of these investors could see their tax rates more than double.

Owners of UK furnished holiday lets are in exactly the same position – they currently qualify for business asset taper relief but will pay capital gains tax at the same rate as everyone else after 6th April.

The biggest winners

The biggest winners are certain groups of buy-to-let investors and some owners of commercial properties let to 'quote' tenants. Currently, if they've only owned their properties for a few years, they qualify for little or no taper relief and could pay tax at 40%. So 18% is a massive saving.

In between these two extremes are investors who are either a bit better off or a bit worse off.

On the winning side would be long-term buy-to-let investors who are also higher-rate taxpayers. Their effective tax rate is currently 24%, thanks to taper relief, so they will welcome the 18% rate.

On the losing team would be basic-rate taxpayers whose effective tax rate could be as low as 12% right now. This will include many non-working spouses and partners in couples who own property jointly.

Other potential losers are investors who have owned property long before 1998 who will lose all their indexation relief.

What about companies?

Lots of people set up companies to invest in property. However, the proposed changes generally only affect private individuals who sell properties.

Companies don't pay capital gains tax – they pay corporation tax – and are completely unaffected by the CGT proposals.

So what's the best way to invest in property now – individually or using a company?

On the face of it the soon-to-be-introduced corporation tax rate of 22% is worse than capital gains tax at 18%. However, companies also qualify for indexation relief, which protects their profits from inflation – individuals receive no protection from next year.

Furthermore, company investors can potentially offset their accumulated rental losses against their taxable gains – individuals are not able to do this, which



is a shame because many property investors have accumulated tens of thousands of pounds of losses.

What about overseas property?

It's important to remember that UK capital gains tax applies to all your properties, whether they're in the UK or abroad.

So all of these changes apply equally to jet-to-let investors (except that foreign holiday letting property was never eligible for business asset taper relief).

Some overseas countries have their own capital gains tax, others do not. It doesn't really matter as far as the UK taxman is concerned – you still fall into the UK capital gains tax net.

However, you don't have to worry about paying tax twice – the general rule is that any tax you pay overseas is allowed as a credit against your UK capital gains tax.

But if your overseas tax is more than your UK tax you cannot claim a refund from the UK taxman. For example, if your overseas capital gains tax is £5,000 and your UK capital gains tax is £3,000, you probably won't have to pay the UK taxman anything, but you cannot ask him to refund the extra £2,000 you paid either.

Non-domiciled investors

At present, a UK resident but non-UK domiciled property investor is generally only liable for UK tax on income or capital gains from foreign properties if these sums are remitted back to the UK. This is known as the 'remittance basis'.

This tax break was extremely powerful because it allowed these 'non-doms' to build a tax-free overseas property portfolio.

However, the 2007 Pre-Budget Report also included proposals to levy an annual charge of £30,000 on non-UK domiciled taxpayers who have been resident in the UK for seven years or more and want to use the remittance basis.

Hence, in future, it appears that such taxpayers will either have to pay tax in full on their overseas property income and capital gains or face a heavy annual charge.

To sell or not to sell?

Many investors who are sitting on big profits are wondering whether they should sell before the changes come into effect. In practice this is easier for stock market investors to do because they can sell quickly without incurring significant expenses.

Property takes longer to sell and the costs are generally higher (legal fees, estate agent's fees etc). It's also expensive to reinvest again (more legal fees, stamp duty etc).

Furthermore, time is rapidly running out. If you wish your sale to take place before 6th April 2008, you must ensure that you have an unconditional sales contract before that date.

Nevertheless, it's worth considering the potential benefits of such a sale to save tax, especially if you were considering selling in 2008 in any case. In particular, any basic-rate taxpayer selling property which they have owned for five years or more may be worse off under the new capital gains tax regime.

Example

David is a landlord with a portfolio of properties. He lives off a salary of £10,000 from a part-time job which he augments by re-mortgaging the properties in his portfolio. He now wishes to sell a buy-to-let property which he bought in October 1998. He expects to realise a gain of £60,000 after taking account of selling expenses etc, and is unsure whether the sale will take place before or after 6th April 2008. David's tax position on a sale before or after the new flat rate comes into force may be compared as follows:

	Before	After
Gain on sale of property	60,000	60,000
Less: taper relief @ 35% (9 years)	21,000	–
	-----	-----
	39,000	60,000
Annual exemption	9,200	9,200
	-----	-----
Taxable gain	29,800	50,800
	=====	=====
Capital gains tax @ 20%/18%	£5,960	£9,144

As we can see, in this example the investor will be more than £3,000 worse off if the sale takes place under the new flat rate regime.

On the other hand, of course, if David were a higher-rate taxpayer, currently paying capital gains tax at 40%, he would be nearly £3,000 better off under the new regime.

There are winners and losers here and you need to know which one you are!

Nick Braun is the founder of Taxcafe.co.uk, which publishes a variety of tax guides including:

- How to Avoid Property Tax
- Using a Property Company to Save Tax
- Tax-free Property Investments, and
- Non-Resident and Offshore Tax Planning.

