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SOMETHING'S GOING ON WITH CGT

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The UK's Capital Gains Tax (CGT) regime has become increasingly complex but offshore bonds remain a consistent planning tool for UK advisers helping their clients to shelter assets that might otherwise have become chargeable to CGT.

What is the current rate of CGT in the UK?

Prior to 2010, that was an easy question to answer. There was a flat rate charge of 18% on all qualifying assets, but since then it's got a whole lot more complex with different rates now applying to residential property and other tax measures that have been introduced to curtail and tax the use of overseas structures that hold such property.

THE SILENT ASSASSIN

CGT came into sharp focus in early August 2022 with the announcement by HMRC that the UK Government had achieved a record tax haul of £14.3bn from CGT in 2020/21[1], an increase of 43% on the previous tax year and more than double that paid in 2014/15. On the current basis, the Office for Budget Responsibility (OBR) predicts that CGT receipts will rise to £20.7bn by 2026/27[2]. In contrast, according to HMRC the tax-take for the more 'visible' inheritance tax (IHT) was £5.4bn in 2020/21, equivalent to less than 40% of the CGT paid [3].

Although the rate of CGT which is payable currently depends on whether you are a basic or higher rate taxpayer, in recent years there have been several additions to this pattern including:

- From April 2019, the CGT rate on disposals of residential property increased from 20% to 28% if a person's taxable income plus the taxable gains on the property tip over into the higher rate tax band. In addition, the CGT on residential property disposals now needs to be paid within 60 days after completion and not in the next tax year;
- From March 2020 the lifetime limit for Business Asset Disposal Relief (BADR), which was previously known as Entrepreneurs' Relief, reduced from £10m to just £1m. HMRC reports that the BADR rate fell by 60% between 2019/20 and 2020/21 and accounted for only 10% of total CGT;
- The CGT Annual Exempt Amount for individuals of £12,300 has been frozen until 2026. With inflation high and likely to remain so for the foreseeable future, freezing the exempt allowance is likely to bring many more clients into the CGT net.

SOMETHING'S GOING ON WITH CGT

Looking more closely at the apparently 'freak' CGT tax haul in 2020/21 announced by HMRC:

- The average CGT bill was £44,272 at an average tax rate of just under 18%;
- Those liable to pay CGT on gains made on the purchase of property or financial assets rose from 53,000 in 2019/20 to 323,000 in 2020/21, a 6-fold increase;
- In 2020/21, 47% of CGT was paid by the 13% of the people who had taxable incomes of more than £150,000, the rate at which additional tax cuts in;
- London and the Southeast of England accounted for approximately 40% of the total number CGT taxpayers in 2020/21 and roughly half of the total CGT paid.

However, most of the increase in the amount of CGT paid in 2020/21 appears to have come from the disposal of chargeable assets ahead of what was expected to be the harmonising of CGT and income tax rates proposed by the Office of Tax Simplification (OTS). This followed Rishi Sunak's request in July 2020 for

[1] https://www.gov.uk/government/statistics/capital-gains-tax-statistics/capital-gains-tax-commentary
[2] Capital gains tax - Office for Budget Responsibility (obr.uk) https://obr.uk/forecasts-in-depth/tax-by-tax-spend-by-spend/capital-gains-tax/
[3] https://www.gov.uk/government/statistics/inheritance-tax-statistics-table-121-analysis-of-receipts

the OTS to carry out a review of CGT as part of the UK Government's post-pandemic plans to rebuild the UK economy. Although no announcement was made in the Autumn Budget 2020, those individuals that did dispose of assets clearly thought that harmonisation was 'priced-in' as this would be entirely consistent with what's been happening to CGT in recent years.

CGT … NOT A TAX THAT'S GOING AWAY ANYTIME SOON

As we've seen this summer, tax, and personal tax in particular,is an emotive issue, one on which political battles are often fought and elections won or lost.

Most governments seek to tax progressively and to achieve a fair balance between taxing income, assets and accumulated wealth on death. Income tax is the most sensitive tax as it's the one most people have to pay. IHT has been more to the fore in recent years as property prices have drawn more people into its net despite the introduction of the residence nil rate band which has been frozen until at least 2026. CGT on the other hand has had a fairly low profile, mainly because it generally impacts only the wealthy who can afford to hold financial assets that attract CGT on their disposal.

However, consensus appears to be emerging across all major UK political parties that the balance between the tax on what people earn (income tax) and the tax on gains from financial assets (CGT) needs to be rebalanced to create greater tax fairness and to simply the tax system. For these reasons, in future years CGT is likely to form a higher proportion of the UK government's total tax-take, regardless of the political party that's in charge.

It's here to stay.

MANAGING THE CGT ISSUE

As ever, in the financial services sector, the best solutions are often the ones that have been around the longest. For UK residents, ISAs and Pensions are all able to shelter gains from CGT when disposing of assets held within each of these defined 'wrappers'.

However, as we've seen, the individuals who are currently being caught in the CGT net are a 'spookily' close match to the typical offshore bond client, many of whom have already exhausted their contribution limits to onshore tax wrapper products.

Traditional offshore bond products continue to offer tax-deferral as bonds are not subject to CGT and are only subject to savings rates of income in the event of chargeable events, which include surrenders and partial-surrenders. This is compared to the associated switching of collective investments and cash funds where CGT can arise where the gains exceed the CGT annual exemption.

In addition, UK advisers and clients can take advantage of newer offshore bond structures which can provide the same tax-deferred solution with a much broader range of assets including:

- Equities listed on regulated exchanges including ordinary and preference shares;
- Funds with limited liability such as investment trusts, ETFs and hedge funds;
- Debt and money market instruments from an approved credit institution including gilts, Eurobonds, commercial paper.

There may well be something going on with CGT, but it seems the solution is already out there.

This information is based on our understanding of current law and taxation practice in the Isle of Man, the UK and Ireland as at 1 September 2022. This could change in the future. Tax treatment is subject to change and individual circumstances.

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