

Introduction

This section outlines the special capital gains tax (CGT) rules for taxing gains made by private investors holding non-business assets such as listed shares. The general principles by which CGT is calculated are the subject of 'General Principles of Capital Gains Tax' on page 1. The rules for business assets are explained in 'Capital Gains Tax for Business Owners' on page 1.

This section deals only with gains made by individual investors. Companies' gains are subject to many special rules, which are not covered here.

General CGT rules for investments

The general CGT rules apply but specific provision is made in respect of particular transactions and assets.

Annual exemption

All individuals are entitled to an annual CGT exemption, which is £10,100 for the 2010/11 tax year.

Ideally investors should aim to make net gains (gains less losses) at least equal to the annual exemption, as an unused exemption cannot be carried forward to future years. Investors should therefore calculate their gains and losses towards the end of the tax year and consider whether to make further disposals.

- If net gains are less than the annual exemption, or the investor has made an overall loss, it might be possible to sell further investments to bring gains up to the level of the annual exemption.
- If gains are higher than the annual exemption, the investor could dispose of assets standing at a loss in order to bring gains down below the level at which tax is payable.

In either case, the investments could be repurchased later if the investor wishes, although it might be necessary to wait 30 days to do so (see page 5, 'Bed and breakfasting').

Couples

Husbands and wives are taxed separately on the chargeable gains they make in a tax year, and each is entitled to an annual exemption.

However, husbands and wives living together can transfer investments between one another free of CGT.

- Gifts of investments before a sale can save CGT when the investments are sold, if one spouse has an unused annual exemption or capital losses.
- The gift must be genuine (ie the sale proceeds must not go straight back to the donor) and ideally should be documented, otherwise HM Revenue and Customs (HMRC) might ignore the effect of the gift for tax purposes.
- Where investments are owned jointly, any gain is apportioned between them in the ratio of their respective interests in that asset at the time of disposal. This will be in equal shares unless otherwise specified.

Partners in a same sex partnership registered under the Civil Partnership Act 2004 are treated in the same way. All the CGT rules that apply to married couples also apply to registered same sex partnerships.

Negligible value claims

Where the value of an asset has become negligible or nil, it is possible to make a claim to establish a loss without disposing of the asset. The loss is treated as arising on the date the claim is made, or any earlier time up to two years before the tax year in which the claim is made, provided that the taxpayer held the asset at the earlier time and its value was negligible at that time.

HMRC periodically provides the publishers of the Extel Capital Gains Tax Service with details of quoted company shares of which HMRC has agreed that the value has become negligible.

Where a building is demolished or has become of negligible value it is possible to claim for it and the land to be treated as separate assets.

Exempt investments

Some investments either are not chargeable assets or benefit from a CGT exemption on any gains arising on their disposal.

The following is a list of the more important ones:

- An individual's only or main residence, often referred to as the principal private residence, or PPR. Where a person, married couple or registered same sex partnership has more than one residence in which they live, they may choose which one is exempt. Their other residence will be subject to CGT in the normal way.
- Investments in personal equity plans (PEPs), individual savings accounts (ISAs) and child trust funds.
- British government securities (gilts) and qualifying corporate bonds.
- National Savings certificates.
- Life assurance policies (but profits from non-qualifying policies are subject to income tax and traded policies are chargeable assets).
- Classic cars.
- Tangible movable property (excluding business assets) with an expected life of 50 years or less.
- Tangible movable property with an expected life of more than 50 years and a value of £6,000 or less.
- Shares issued under the enterprise investment scheme (EIS) and the business expansion scheme (BES) after 18 March 1986. The exemption applies only on their first disposal, the income tax relief granted must not have been withdrawn and the shares must have been held for three years. Losses on EIS shares are allowable.
- Shares in venture capital trusts (VCTs) that qualified for income tax relief.
- Shares held by employees in a share incentive plan (SIP) up to the date they are transferred to the employee.
- Trees in woodlands managed by the occupier on a commercial basis. If the land is sold, any consideration attributable to the trees is excluded from the computation of the capital gain.

Entrepreneurs' relief

Entrepreneurs' relief on certain business sales reduces the effective CGT rate to 10%.

- However, sales of shares qualify only if the shareholder is a director or employee of the company and holds shares giving at least 5% of the voting rights.
- Sales of property qualify only if they are connected with the disposal or cessation of the business, and certain other conditions are met.
- Therefore most shares and properties held as investments will not qualify for entrepreneurs' relief.

Losses

For each tax year, the taxpayer must calculate any losses incurred in that year together with any losses brought forward. Losses made in a year have to be set against gains made in the same year. Losses brought forward need only be set off against gains in excess of the annual exemption.

Example

Alfred, who has allowable losses brought forward of £35,000, sells shares in 2010/11 as follows:

Company	Proceeds £	Cost £	Gain/ loss £
A	10,000	20,000	(10,000)
B	50,000	20,000	30,000
C	40,000	20,000	20,000

Alfred has realised a loss of £10,000 (£20,000 – £10,000) on the sale of shares in A and gains of £50,000 on the sales of shares in B and C (£30,000 + £20,000).

So his net gain for 2010/11 is £40,000.

The annual exemption for 2009/10 is £10,100.

Therefore £29,900 of the brought forward losses is set against the £40,000 net gain of 2010/11, leaving £10,100 chargeable and covered by the annual exemption.

The remaining £5,100 (£35,000 – £29,900) of the losses is carried forward and available against gains in future tax years.

Shares

In general, shares of the same class held by one taxpayer are pooled, making it unnecessary to match sales with specific purchases. However, there are some circumstances in which shares must be identified.

- It is important to remember that these rules apply only for the purposes of matching shares or securities of the same class.
- They do not apply to other types of assets, for example, land and buildings.

Identification rules

Disposals are identified with acquisitions in the following order:

1. Acquisitions made on the same day.
2. Acquisitions made within the following 30 days, but not any shares acquired when the person is neither resident nor ordinarily resident in the UK.
3. All shares of the same class in the same company. They are treated as forming a single asset (a 'share pool') regardless of when they were originally acquired.
4. Shares acquired more than 30 days after the date of disposal.

Explanatory notes

- Category 2 counters bed and breakfasting (see below, 'Bed and breakfasting'). Where shares are sold and reacquired within a 30-day period, the earlier sale is now matched with the later purchase. The rule is modified where a taxpayer becomes non-UK resident to counter avoidance schemes.
- Category 4 is rather unusual, and is unlikely to be found much in practice. It could happen if, for example, taxpayers sold by mistake more shares than were owned by them, with the result that they had to acquire further shares to satisfy the bargain. It might also happen where there is an unconditional contract to acquire the shares at a later date.
- A bonus issue of shares is treated as having been acquired on the same day as the original holding.
- A takeover, where shares are exchanged for shares in the new company, is not a disposal and is not taxable. In other words, the new shares are regarded as 'standing in the shoes' of the old shares.

The following example illustrates how the rules work.

Example

Dominic bought shares in M as follows:

Date	No of shares	Cost
1 June 1979	500	£250
1 June 1986	1000	£400
1 June 1997	1,500	£1,200
1 June 2001	500	£300
1 June 2007	1000	£1000
Total	4,500	£3,150

On 1 May 2010 he sells 1,500 shares for £2,000.

The shares sold are matched with 1,500 of the 4,500 shares in his share pool. Therefore his chargeable gain is:

$$£2,000 - (£3,150 \times 1,500/4,500) = £950.$$

Bed and breakfasting

The matching rules counter the once common practice of bed and breakfasting.

- Bed and breakfasting was the simple procedure of selling ('bedding') and buying ('breakfasting') shares on consecutive days, enabling individuals either to realise gains (to use their annual CGT exemption) or to establish losses to set against gains made in excess of the annual exemption. There are still ways in which one can achieve a result similar to bed and breakfasting, with care.
- It is still possible to sell and then buy shares to create gains or losses, but the two transactions must now be at least 30 days apart rather than taking place on consecutive days. A taxpayer who decides to use bed and breakfasting in this form will be exposed to real price movements in the period, and this could create an unexpected gain or loss. It is also likely that transaction charges will be higher than under 'traditional' bed and breakfasting, because the commission charged to arrange a bed and breakfast deal was generally at a much lower rate than the normal dealing charge.
- Another way to bed and breakfast shares is by means of an individual savings account (ISA). The strategy here is to sell the shares into the market, with a matching acquisition of shares using the ISA. Clearly, the opportunities for this type of transaction are more limited than with traditional bed and breakfasting. A similar approach is possible using self-invested personal pensions (SIPPs).
- A more practical solution is for a husband and wife (or civil partners) jointly to undertake a bed and breakfast.
 - For example, the husband would sell shares while his wife would buy, say, an equal number of shares.
 - If the position is looked at jointly, they have merely 'exchanged' their shares, but provided a real acquisition and disposal have been made, this is a valid bed and breakfast.
 - A husband and wife will need to keep separate share portfolios.
 - For this to be effective, of course, the shares must be actually sold and acquired 'in the market', and not merely sold or gifted to the other spouse. If shares were simply transferred to the other spouse no gain or loss would arise, and the transaction would be ineffective for tax purposes.
 - HMRC has said that in some circumstances it might invoke anti-avoidance legislation in the Finance Act 2007 to deny relief for a capital loss where one spouse sells shares and the other buys a similar holding with the main purpose of gaining a 'tax advantage'. Exactly where HMRC will draw the line between acceptable sales and unacceptable ones is unclear.
- There is nothing to prevent investors making adjustments to their portfolio, for example, selling shares and using the opportunity to acquire other shares, perhaps another blue chip stock in the same sector with a similar rating. This can achieve tax effects similar to a bed and breakfast transaction.
- If the risk of price movements is too great, it might be possible to bed and breakfast by selling and buying back the shares using the 30-day rule and taking out options to 'lock in' to a purchase price. The use of options to hedge the transaction and reduce the risk could be attractive, although options are only available in major listed stocks. It is also likely to be relatively expensive in transaction costs, not least because the option price will reflect the risk that the share price will move in the option period. The use of options may be suitable only for the more sophisticated investor, and even then only for transactions

above a certain monetary size and/or amount of gain. For some exchange traded funds (ETFs) linked to market indices, it is now possible to bed and breakfast the same underlying asset by selling shares in one provider's ETF and buying shares in the corresponding ETF of another provider.

Pooled investments

Pooled funds, such as unit trusts, open-ended investment companies (OEICs) and investment trusts, have some tax advantages compared to direct investments into equities.

- Once the units (or shares in investment trusts or OEICs) are acquired, it is only when the units are sold that the investor will face a CGT charge.
- When the investment manager sells and acquires stocks in the fund underlying the units, there is no CGT.
- If the underlying stocks were held directly by the individual, a charge to CGT would arise on each sale.
- The use of pooled funds as against direct investment might increase the investment costs, which must be set against the potential tax saving.
- Where an investor has a substantial sum of cash to invest in a portfolio of stocks and shares, another possible solution is to use a private unit trust.
 - In effect, private unit trusts are approved unit trusts, thus enjoying the CGT exemption, while being structured such that the only unit holders are, perhaps, an individual, their family members or a discrete group of individuals.
 - Private unit trusts could therefore offer the benefit of active management, perhaps with a specialised investment philosophy, while avoiding CGT on individual disposals.
 - Private unit trusts are not common, but they are offered by some fund managers. The minimum investment is typically measured in millions.
 - In theory, private unit trusts can be used for an existing portfolio. However, usually this will mean incurring substantial CGT on disposal of the underlying investments, which defeats the object of the exercise.

Life policies

The proceeds of life policies are generally exempt from CGT. Although 'chargeable gains' arise on life policies, these are subject to income tax. A disposal of a qualifying life policy (eg a regular premium endowment contract) is liable to CGT if the individual who makes the disposal is not the original owner and paid for the policy.

- In addition, disposals of qualifying policies are liable to CGT if the individual making the disposal received the policy as a gift, or following a series of gifts, and someone who was not the original owner paid for the policy.
- Qualifying policies received as a gift, where no one after the original owner paid for the policy, are still exempt.

Tax planning key points

This section gives a brief outline of the CGT rules for common investments in the hands of individuals. In many situations the rules are complicated, and this section only covers the main areas. Specialist advice should always be sought.

This guide is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking action on the basis of the contents of this publication. The guide represents our understanding of the law and HM Revenue & Customs practice as at May 2010, which are subject to change.