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Make The Most Of Capital Losses

When a capital asset is disposed of (which includes sales, gifts, swaps or receipts of compensation), it may precipitate a capital gain or a capital loss. In the unfortunate event that you make a loss on the sale of your asset, you can generally offset the loss against any other gains you make in the same year or in the future. However, capital losses are not transferable and therefore cannot, for example, be transferred from one spouse or civil partner to the other – the capital gains of one spouse cannot be offset against the capital losses of the other.

Ordering of losses

A strict order applies for setting-off capital losses against capital gains. Firstly, losses arising in the tax year are offset against any other chargeable gains for the same year. You must deduct all your losses for the year, even if this results in chargeable gains after losses below the level of the capital gains tax (CGT) annual exempt amount. If the allowable losses arising in the tax year are greater than the total chargeable gains for the year, you can carry forward the excess losses to be deducted from chargeable gains in future years.

Reducing the chargeable gain

The next step is to look at any unused losses available from a previous tax year.

If chargeable gains remain after deducting the allowable losses arising in the year, any unused allowable losses brought forward from an earlier year may be deducted. However, you only need to deduct sufficient allowable losses brought forward to reduce the chargeable gains after losses to the level of the CGT annual exempt amount. Any remaining losses brought forward are carried forward again without limit, to be deducted from chargeable gains in future years.

Example – Losses brought forward

In 2014/15, Edward makes total chargeable gains of £15,000 and has allowable losses of £3,000. He also has unused allowable losses available from an earlier year of £8,000.

He deducts the current year losses first from his gains (£15,000 – £3,000), which leaves a chargeable gain of £12,000. Next, he deducts £1,000 of the losses brought forward, to take his chargeable gains down to £11,000 (the level of the CGT annual exemption for 2014/15). He can then carry forward the remaining unused losses of £7,000 (£8,000 – £1,000) to be used against chargeable gains arising in future years.

As his chargeable gains after losses don't exceed the annual exempt amount for 2014/15, Edward doesnot have to pay any CGT.

Year of death

Capital losses cannot be carried back to earlier tax years, except with respect to unused capital losses arising in the year of death of the individual, which can be carried back for up to three tax years. The same approach as above is adopted with respect to the carry back of capital losses following death.

Negligible value claims

It is possible to claim losses on assets that you still own if they become worthless or of 'negligible value'. Providing certain conditions are met, the asset is treated as though it was sold and immediately reacquired at the time the claim is made for an amount equal to its value. It is possible to specify an earlier date, falling in the two previous tax years, for the deemed disposal. A resulting loss arising from a negligible value claim can be used to reduce your income tax liability for the year, if the loss relates to qualifying shares where certain conditions are satisfied. Further information on negligible value claims is given the HMRC Helpsheet 286: "Negligible value claims and Income Tax losses on disposals of shares you have subscribed for in qualifying trading companies."

Practical Tip:

The annual CGT exemption is a 'use-it-or-lose-it' allowance – if you don't use it in one tax year, you can't carry it forward to the next tax year. If you are thinking about selling, say, a bundle of shares, consider selling some shares at the end of one tax year and some at the beginning of the new tax year. In this way, you can use the capital gains annual exemptions for two years and (under current rates) could save up to £6,160.

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Main Residence CGT Exemption - How To Lose It!

The capital gains tax (CGT) legislation which provides for relief on the disposal of a private residence includes a provision (in TCGA 1992, s 224(3)) which appears to deny the normal exemption for capital gains on a 'main residence' if you hoped to sell it at a profit when you bought it.

At the first reading, section 224 (3) seems to do away with almost all the CGT exemption. It says the main residence exemption:

"...shall not apply in relation to a gain if the acquisition of, or of the interest in, the dwelling-house or the part of a dwelling-house was made wholly or partly for the purpose of realising a gain from the disposal of it, and shall not apply in relation to a gain so far as attributable to any expenditure which was incurred after the beginning of the period of ownership and was incurred wholly or partly for the purpose of realising a gain from the disposal" (emphasis added).

Notice those two uses of 'or partly'- most of us hope to sell our homes at a profit one day, and adverts for home improvements like conservatories often make the point that this will increase the value of the property concerned. So are we all doomed to pay tax when we sell our homes? Fortunately, HMRC's Capital Gains manual instructs its staff to behave reasonably and not use the legislation in cases like these:

"It would be unreasonable and restrictive to apply the legislation in this way. The subsection should only be taken to apply when the primary purpose of the acquisition, or of the expenditure, was an early disposal at a profit" (Cg65210).

HMRC generally use the legislation in three situations:

1. Quasi property development

It is difficult for HMRC to establish that someone who buys a run-down house, does it up, and then sells it in a short period of time is trading as a property developer if he genuinely lives in the property while he does so, and he has no other residence at the time, but they may use section 224(3) to charge CGT on the profit made.

2. Leasehold Enfranchisement

Tenants under a lease may get the opportunity to buy the freehold from their landlord. This is generally a sensible investment, but if you then sell the freehold shortly afterwards, you may find section 224(3) rears its head, as far as the gain attributable to the freehold is concerned.

3. Extensions and conversions

A house divided into flats will often sell for more than the same house undivided. If you do this (or build an extension) shortly before sale, then some of the gain may not be exempt.

4. Calculating the lost exemption

Except in the case of the 'property developer', it is not all of the gain that is taxed; it is only the part relating to the offending expenditure. This involves a valuation exercise.

For example, imagine a house converted into three flats and immediately sold. Each flat sells for £150,000, whereas the unconverted house would have sold for £350,000. The conversion work cost £50,000. The taxable gain is as follows:

Sale proceeds of three flats at £150,000 each	£450,000
Estimate of sale proceeds of unconverted house	(£350,000)
Gain attributable to conversion	£100,000
Less cost of conversion	(£50,000)
Taxable gain	£50,000

The longer the period between the expenditure and the sale, the less risk there is of section 224(3) being trotted out, especially if you can show another reason for the expenditure (an extension for a growing family, for example).

Practical Tip:

Do not let section 224(3) put you off sensible expenditure to enhance the value of your home. In the example above, assuming the £11,000 annual CGT exempt amount is available, the CGT payable is, at worst, under £11,000 (less if the property is jointly owned), so you are still better off for doing the conversion.

Training Costs For The Self-Employed – What Is Allowable?

HMRC's attitude to training costs incurred by the self-employed (sole traders and members of partnerships) is irrationally restrictive, and largely based on misinterpreting an irrelevant tax case. Their official instructions are bad enough, but local officials go on to misinterpret their Head Office's misinterpretation to deny almost all claims for training costs.

HMRC's view

HMRC's views are set out in their Business Income manual (at BIM35660), which begins:

"Expenditure incurred by the proprietor of a business on training courses for themselves is revenue expenditure if the course merely updates existing expertise or knowledge. Expenditure on a course which provides new expertise or knowledge is capital."

The 'logic' behind this (incorrect) view is that 'knowledge' and 'expertise' are capital assets, like factories and cars, so 'updating' is allowable because it is like repainting the factory or having the car serviced, whereas 'new' expertise or knowledge is a new capital asset.

The paragraph goes on to quote a Special Commissioners case – Dass v Special Commissioner and Others [2007] STC 187. Should you find yourself disputing training costs with HMRC, this case will be quoted as authority for the proposition that training is a capital expense.

What they will not say (because it is not mentioned in BIM35660, and you actually have to read the report of the case to discover it) is that Mr Dass's claim was for examination fees, not training costs, and that it was rejected because his training course lasted two years and FA 1991, s 32 (i.e. obsolete legislation now, but then the authority for his claim for exam fees) restricted relief to courses lasting only one year.

On the basis of this irrelevant tax case, HMRC seek to deny any relief for 'new' training. The argument runs:

"…your client had only recently started letting property (or double-glazing windows, or whatever) so the training course must have provided him with new knowledge and therefore it is capital. This was a new venture so there was no upgrading of existing skills."

The second sentence is quoted verbatim from a recent letter from HMRC on one of my clients – they backed down after I replied explaining basic tax rules to them.

What is the correct approach?

The correct analysis is based on fundamental tax and accountancy principles. If expenditure brings into existence an 'enduring advantage' for the trade, then it is capital. There is a string of decided cases stating this, of which the granddaddy is British Insulated and Helsby Cable Ltd v Atherton HL 1925, 10 TC 155.

Note the word 'enduring'. I think I would accept that the cost of acquiring a specific professional qualification such as membership of the Chartered Institute of Taxation might be capital, but learning something new does not lead to an 'enduring' advantage unless it also leads to a formal qualification which is required in a particular trade or profession.

The distinction between 'updating' and 'new knowledge' is a distinction without a difference. Every year I attend a training course on that year's Finance Act. Does that 'update' my tax knowledge, or does it give me 'new' knowledge about a new piece of legislation? You only have to think of an example to see that the absurdity of HMRC's analysis - is a mechanic on a training course about servicing hybrid motors 'updating' his knowledge of cars, or getting 'new' knowledge of a new type of engine?

Personally I regard time spent at a training course wasted unless I learn something new as a result.

Practical Tip:

Unless the training led directly to a specific qualification needed for the business (Mr Dass was after an NVQ as part of the process of qualifying as a solicitor) do not accept HMRC's attempts to disallow it as 'capital'.

Personal Tax

Use Rounding In Your Tax Return

If you have income that includes 'pence', round down these figures.

For expenses always round them up.

Multiple figures for one entry cannot be rounded until the final figure is calculated, at which point this figure can be rounded up or down as appropriate.

This may not save you a lot of tax but every little bit helps!

Case Study:

Barry is self-employed and uses 15 boxes in total on his Tax Return.

By rounding, he may save tax on up to £14.85, equating to a saving of £5.94 in tax for a 40% taxpayer. Enough for a drink!

Property Tax

'Hold-Over' Relief

'Hold-over' relief is a way of deferring payment of CGT on certain assets, including land and buildings used in a business, until the new owner of the asset sells. The donee, in effect, takes over the original cost of the asset and may eventually have to pay CGT on both the gain incurred from the date of gift plus the gain 'held over'.

HMRC have produced Help Sheet 295 'Relief of gifts and similar transactions' that details the procedure. A claim form needs to be signed and submitted.

Case Study:

Judy owns a second home which shows a significant gain. She gives the cottage to her husband Jim.

This is treated as a 'no gain/no loss' disposal between them as they are married. Jim is treated as acquiring the cottage for the price that Judy paid originally (so preserving the gain in his hands), as from the date of the inter-spouse disposal.

Jim manages the property as a qualifying furnished holiday let and after a year gives the property to their adult daughter, Louise, claiming hold-over relief so that Louise takes over her mother's historic base cost.

Louise subsequently occupies the property as her only or main residence. When the property is sold full PPR relief will be allowed.

Business Tax

Capital Allowances Must Be Claimed

Capital allowances are not given automatically. They must be claimed and they must be claimed within the time limit.

A claim can be made in the tax return. This will be the self-assessment return for an individual, the partnership return for a partnership or the corporation tax return for a company.

The time limit by which capital allowances must be claimed depends on the nature of the business:

- **Self-employed:** 12 months after the 31 January deadline for filing the return.
- **Partnership:** 12 months after the 31 January deadline for filing the return.
- **Company:** 12 months after the filing date for the return for the accounting period to which the claim relates.

Case Study:

Elizabeth is a self-employed caterer. She prepares accounts to 31 March and purchases various items of catering equipment during the year to 31 March 2014 in respect of which capital allowances are claimed.

She claims the allowances in her 2013/14 tax return, which is filed by the filing deadline of 31 January 2015.

The deadline for claiming capital allowances for 2013/14 is 31 January 2016. This is 12 months from the filing date for the 2013/14 return of 31 January 2015.

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