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New Lower Rates Of CGT – But Not For All!

In a surprise Budget 2016 announcement, the Chancellor reduced the rates of capital gains tax (CGT) on most chargeable gains.

From 6 April 2016, capital gains are charged at 10% to the extent chargeable income and gains fall within the basic rate band (£32,000 for 2016/17), and at 20% once the basic rate band has been used up. However, in a twist that hits buy-to-let investors, the new rates of 10% and 20% do not apply to gains on residential property (or carried interest), which continue to be taxed at 18% to the extent that the basic rate band is unused, and at 28% where the taxpayer is a higher or additional rate taxpayer. Gains taxable in respect of residential property and carried interest are referred to as 'upper rate' gains.

The annual exempt amount remains at £11,100 for 2016/17.

Gains qualifying for entrepreneurs' relief or the new investors' relief are taxable at 10%, subject to availability of lifetime limits. However, where gains are taxable at 10% as a result of these reliefs, they have first call on the basic rate band to the extent that it remains available. This means that access to the lower rates of CGT (10% or 18% depending on the nature of the gain) are reduced or eliminated where these reliefs are due.

'New look' CGT

As a result of the changes, the structure of CGT has become more complicated, and now looks like this:

	Chargeable gains falling within basic rate band	Chargeable gains falling within higher or additional rate band
Gains other than residential property gains and carried interest	10%	20%
Residential property gains and carried interest	18%	28%
Gains qualifying for entrepreneurs' relief or investors' relief	10%	

Working out the CGT liability

Where the taxpayer has no gains from residential property or benefits from entrepreneurs' or investors relief, the position is straightforward. Net chargeable gains in excess of the annual exempt amount are taxed at 10% to the extent that they fall within the basic rate band, and at 20% otherwise.

Example 1: Sale of investment shares

In 2016/17, James sells some shares and realises a gain of £25,000. He has a salary of £31,000 and no other income or gains.

His personal allowance of £11,000 is set against his salary, leaving £20,000 taxable at the basic rate. This utilises the first £20,000 of the basic rate band, leaving £12,000 of the basic rate band unused. The exempt amount for CGT purposes for 2016/17 is £11,100. After deducting this from James' gain of £25,000, James is left with a chargeable gain of £13,900. The first £12,000 of this gain falls within the unused basic rate band and is taxed at 10% and the remaining £1,900 of the gain is taxed at 20%.

Therefore, CGT payable by James is £1,580 ((£12,000 @ 10%) + (£1,900 @ 20%)).

Residential gains only

Where the taxpayer has a residential gain which is not covered by the main residence exemption in respect of either a UK or foreign property, the gain is taxed at the rates applicable to upper rate gains of 18% or 28%, depending on the extent to which the chargeable gain falls within the basic rate band. This will apply, for example, to a gain on the sale of an investment property, such as a buy-to-let or a second home, which is not the taxpayer's main residence.

Example 2: Sale of buy-to-let property

Helen sells a buy-to-let property, realising a gain of £40,000. She is a higher rate taxpayer. After deducting the annual exempt amount, the chargeable gain is £28,900. As her basic rate band, has been fully utilised, the gain is taxed at the higher rate applicable to upper rate gains of 28%, giving rise to a capital gains tax liability of £8,092 (£28,900 @ 28%).

Mixed gains

Where in 2016/17 or a later tax year a taxpayer has residential and non-residential gains, he can allocate the annual exempt amount and any unused basic rate band in the most beneficial way. This will generally mean setting the annual exempt amount against any residential gains, as these are taxed at a higher rate.

Example 3:
Sale of buy-to-let property and investment shares

In 2016/17, Robert makes a taxable gain on the sale of a buy-to-let property of £30,000 and a gain on the sale of some shares of £6,000. He has £10,000 of his basic rate band remaining.

The annual exempt amount of £11,100 is set against the residential gain, leaving chargeable residential gains of £18,900 and chargeable non-residential gains of £6,000.

As the differential between the rates is 8% regardless of whether they fall within the basic rate band or not, once the annual exempt amount has been used, it does not matter whether the residential or non-residential gains are allocated to the remaining basic rate band.

Whichever allocation is used; the capital gains tax is £5,492 (i.e. ((£10,000 @ 18%) + (£6,000 @ 20%) + (£8,900 @ 28%)) or ((£6,000 @ 10%) + (£4,000 @ 18%) + (£14,900 @ 28%)).

Practical Tip :

Where there are residential and non-residential gains, set the residential gains against the annual exempt amount first to minimise the total CGT payable.

IN THIS ISSUE

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Gifting Property - IHT Free?

The inheritance tax (IHT) regime includes various useful reliefs and exemptions. Furthermore, certain categories of relief and exemption are not subject to a fixed upper monetary limit, if the relevant conditions are satisfied. Some of them are better known than others.

Perhaps one of the less well known IHT 'exemptions' (i.e. whereby a disposition is not treated as a transfer of value for IHT purposes) relates to the maintenance of family members. This applies broadly to the following:

- maintenance of the spouse (or civil partner), or former spouse (e.g. on divorce);
- maintenance, etc., of the transferor's children;
- maintenance, etc., of other people's children;
- care or maintenance of a dependent relative; or
- maintenance, etc., of the transferor's illegitimate children.

The exemption is subject to certain conditions in each case (see IHTA 1984, s 11).

Is that 'reasonable'?

For example, the exemption in respect of 'dependent relatives' (as defined) applies to the extent that the disposition represents a reasonable provision for care and maintenance of the relative. But what is a 'reasonable provision'?

This point was considered in McKelvey (Personal Representative of McKelvey Deceased) v Revenue and Customs Commissioners [2008] SpC 694. In that case, the deceased (D) was a spinster who lived with her widowed mother (M), who was 85 years old, blind and in poor health. D was diagnosed with terminal cancer, and in 2003 gave away two houses she owned to M. D died in 2005, and M died in 2007.

HM Revenue and Customs (HMRC) sought to charge IHT on the value of D's gift of the houses to M of £169,000. D's executor appealed, on the grounds that the gifts were exempt transfers, being a reasonable provision for the care and maintenance of a dependent relative (within s 11(3)). The executor contended that D gave the houses to M so that they could be sold to pay for nursing care. The executor's appeal was allowed in part. The Special Commissioner held that it was reasonable for D to assume that M would need residential nursing care, and concluded that 'reasonable provision at the time the transfers were made amounted in all to £140,500'. This amount qualified for exemption under s 11 (NB the balance of £28,500 was a chargeable transfer).

HMRC's guidance on what represents 'reasonable' provision for the care or maintenance of a dependent relative (at IHTM04177) indicates that regard needs to be given to the financial and other circumstances of the transferor and the relative and the degree of incapacity of infirmity of the latter. HMRC will enquire into the recipient's 'financial incapacity', and will refuse the exemption to the extent that the recipient had sufficient income or capital to make adequate provision for their own maintenance (IHTM04179).

'Deathbed' planning?

The exemption may be potentially useful if (for example) the transferor's life expectancy is less than the seven-year period necessary for a potentially exempt transfer to become exempt, or the normal two-year ownership period normally required for business property relief.

For example, suppose that Susan (age 38), the single mother of Jacob (age 6) has been diagnosed with a terminal illness. Her assets (which include a property and investment funds inherited from her parents) are worth over £1.4 million. Susan's estate would be liable to IHT on death, subject to her available nil rate band. Her main concern is to provide for Jacob. Consideration could be given for IHT purposes to the legislation in IHTA 1984, s 11(4) (dealing with the maintenance, education or training of an illegitimate child of the person). The exemption applies to lifetime dispositions, so provision for Jacob would need to be made prior to his mother's death. Such provision (to the extent that it falls within s 11) would not become chargeable to IHT on Susan's death.

Practical Tip :

Care must be taken, such as in quantifying how much might fall within the IHT exemption and (particularly in the case of minor children) how the funds will be held and applied for the recipient. Expert professional advice is recommended.

Tax Return Errors: They Told Me To Do It!

Errors are sometimes made in tax returns. This can result in HM Revenue and Customs (HMRC) seeking to impose penalties in respect of the errors. The calculation of penalties for errors, etc. is beyond the scope of this article, but there is guidance in HMRC's Compliance Handbook manual (including a table of 'standard' maximum penalties at CH82120).

If the tax return error has resulted (for example) in a tax liability being understated, HMRC will generally consider whether the error was careless or deliberate. An error is 'careless' if it arises due to a failure to take reasonable care (FA 2007, Sch 24, para 3(1)(a)). Thus, no penalty can be charged if the error arose despite reasonable care having been taken.

Is it 'reasonable' or not?

Unfortunately, there is no statutory definition of 'reasonable care' for these purposes. This has resulted in case law over the years on the distinction between reasonable care and careless (or negligent) behaviour.

For example, in Collis v Revenue & Customs [2011] UKFTT 588 (TC), the First-tier Tribunal commented: 'We consider that the standard by which [reasonable care] falls to be judged is that of a prudent and reasonable taxpayer in the position of the taxpayer in question.'

HMRC considers that reasonable care depends on the particular taxpayer's abilities and circumstances. However, HMRC generally expects higher standards of taxpayers with professional advisers.

Incorrect advice

However, has a taxpayer taken reasonable care in relying on professional tax advice, if that advice results in a tax return error? The answer seems to be 'it depends'. For example, in Gedir v Revenue & Customs [2016] UKFTT 188 (TC), the First-tier Tribunal held that the taxpayer took reasonable care despite a tax return error. In reaching that conclusion, the tribunal noted the following 'essential elements':

- the taxpayer consulted an adviser he reasonably believed to be competent;
- he provided the adviser with the relevant information and documents;
- he checked the adviser's work to the extent that he was able to do so; and
- he implemented the advice.

The tribunal noted the earlier case Hanson v Revenue and Customs [2012] UKFTT 314 (TC), and considered that the decision in that case sets out the correct basis for establishing whether a taxpayer who uses an agent to complete his tax return has taken reasonable care to avoid an inaccuracy in the return. In Hanson, the First-tier Tribunal considered that there was carelessness on the part of the taxpayer's advisers. However, the taxpayer had taken reasonable care to avoid the error. In the circumstances, the taxpayer was entitled to rely on his accountants' advice without the taxpayer consulting the legislation or any HMRC guidance.

On the other hand, a taxpayer's reliance on professional advice does not represent a 'get out of jail' card in all circumstances. For example, in Shakoor v Revenue and Customs [2012] UKFTT 532 (TC), the tribunal found that an accountant's incorrect advice was obviously wrong, and that the taxpayer realised, or ought to have realised, that it was obviously wrong, or so potentially wrong that it called for further explanation or justification. The taxpayer therefore incurred a penalty.

Practical Tip:

Taking a different view from HMRC on a technical point is not necessarily careless behaviour, if the taxpayer's adviser's view turns out to be incorrect. Provided that the view is reasonable, the adviser is entitled to advise the taxpayer on that basis. The First-tier Tribunal decisions in Gedir and Hanson on reasonable care do not create a binding precedent, but may be persuasive in cases where the taxpayer has made a tax return error concerning a point on which professional advice has reasonably been taken, and HMRC is contending that the error was careless.

Personal Tax

'Rent-A-Room' relief

The 'Rent-A-Room' relief scheme is an optional tax exemption scheme that allows property owners who let out spare furnished rooms in their only or main home to receive up to £7,500 per annum gross and not be subject to tax.

If the rent received exceeds £7,500, the first £7,500 is tax free, income tax being paid on the balance. This obviously covers income from lodgers and may also be applied to bed and breakfast or guest houses which would usually be assessed to tax as a trade. The exemption limit of £7,500 is reduced to £3,750 if, during the tax year, someone else receives income from letting from the same property.

The limit is not reduced if the room is let for less than 12 months, or if rented for only one month or just rented out in term time. The owner and lodger must occupy the property for at least part of the letting period in each tax year of claim.

Case Study:

Sisters Jane, Julie and Rose inherited a six-bedroom house from their father. The sisters live in the property as their main residence and it is large enough such that three of the bedrooms are let.

The 'Rent-A-Room' relief rules state that the limit is halved if 'someone else received income from the same property'.

The sisters are therefore each entitled to claim the £3,750 exemption such that the total exemption amount is £11,250 (i.e. 3 x £3,750).

It is irrelevant that the total exemption amount exceeds the £7,500 limit.

Property Tax

Gift Of PPR To Spouse/Civil Partner

Where there is an inter-spouse/civil partner transfer of a Principal Private Residence (PPR), the donee is still treated as having acquired the property at the donor's base cost but with one added twist – the donee's period of ownership is deemed to commence not at the date of transfer but instead at the date of the original acquisition by the donor.

Furthermore, any period during which the property was the main residence of the donor will also be deemed to be that of the donee such that the transaction is backdated.

This is only relevant to properties that are (or have been nominated as) the main Principal Private Residence.

Case Study:

Joe purchases property 1 in his sole name as a main residence. A few years later he marries Jane, moves into property 2 and lets out property 1. Ten years later there is a large capital gain accruing on property 1.

Joe then transfers property 1 to Jane on a 'no gain/no loss' basis and they start also to occupy property 1 as a residence.

Joe and Jane elect property 1 as the main PPR. A few weeks later a further election is made back to property 2. Over the next few months Joe and Jane live in property 1 as a residence before the property is sold.

Under this specific ruling property 1 is deemed to be the main PPR for the period from the date of purchase to the date of transfer; then as the property has been a residence, the period between the date of transfer and the date of sale is also capital gains tax-free as it is covered by the 18-month rule.

Business Tax

Business Use Of Home: Fixed Deduction

To save the work involved in calculating the proportion of household expenses that are deductible where a home is also used for business purposes, under the simplified expenses rules, a statutory deduction is available for business use of home. The statutory deduction can be used by sole traders and by partnerships where all the partners are individuals. It is not available to companies.

You can claim a fixed deduction each month in respect of business use of your home. The amount of the deduction depends on the number of hours spent at home during that month working wholly and exclusively on the business (including any hours worked by employees). The fixed monthly deductions are as shown in the table below.

No. of hours worked at home in month	Monthly deduction
25 to 50	£10
51 to 100	£18
101 or more	£26

Case Study:

Nicola is self-employed as a beautician. She carries out treatments both at clients' houses and at home. She also undertakes the business administration at home. Each month she spends 60 hours working at home. She claims a fixed rate deduction by reference to the set amount of £18 per month.

This equates to an annual deduction of £216.