Bloomsbury Professional
Tax

Excerpt from Property Taxes 2019/20 – Chapter 11 – Tax on Chargeable Gains

INTRODUCTION

11.1

Capital gains tax (CGT) is chargeable on gains accruing on the disposal of assets which are not taxable as income, for example as profits of a trade of property dealing (*TCGA 1992, ss 15, 37*). For individuals, other than basic rate taxpayers, and trusts the tax is charged at a flat rate of 28% on residential property and 20% on other assets (28% on disposals prior to 6 April 2016). A basic rate taxpayer is taxable at 18% on residential property and 10% on other assets but only up to the unused portion of his basic rate income tax band. The 28% rate applies to gains above that level. The 28% and 18% rates also apply to carried interests in relation to investment management, but this does not normally arise in a property context. Where an individual has unused basic rate band, this must first be utilised against any gains which attract entrepreneurs' relief (see **11.107**). Once this shortfall has been so utilised (or if there are no entrepreneurs' relief gains) the taxpayer can choose which gains should utilise that excess (*TCGA 1992, s 4BA* inserted by *FA 2016, s 83(14)*). The special residential property rate applies to both UK and non-UK residential property interests (other than those to which NRCGT applies) (*TCGA 1992, s 4BB(1)–(3)* inserted by *FA 2016, s 83(14)*).

11.2

There is an annual exemption of the first slice of taxable gain. This is £12,000 for 2019/20, (£10,900 for 2013/14, £11,000 for 2014/15, £11,100 for 2015/16 and 2016/17, £11,300 for 2017/18 and £11,700 for 2018/19). A husband and wife each have their own annual exemption. There is no similar exemption for companies and most trusts have an annual exemption of half that applicable to an individual, ie currently £6,000. Non-UK residents are not generally liable to CGT. Some non-resident companies, trusts and partnerships were brought within the charge to tax on gains from 6 April 2013 relating to residential properties valued at over £1 million and from 6 April 2016 on those valued at over £500,000 (ATED related gains – see **11.246**). All non-residents are liable to tax on gains in relation to disposals of UK residential properties (NRCGT gains: see **11.203**) from 6 April 2015 and on other UK property from 6 April 2019.

11.3

Companies are not chargeable to CGT but are chargeable to corporation tax on their chargeable gains. The CGT rules apply to calculate chargeable gains. A company's chargeable gains forms part of its taxable income, ie the company is chargeable to corporation tax on the aggregate of its profits and chargeable gains. The rate of corporation tax is currently 19% but will reduce to 17% from April 2020. Whilst this superficially makes it attractive to make property investments through a company, it needs to be borne in mind that money cannot be extracted from a company without further tax, so the total tax rate on gains on such property is significantly higher than the 20% or 28% rate payable if the property is held personally

11.4

A non-UK resident is chargeable to CGT on –

(a) assets situated in the UK that are used in a UK branch or agency;

(b) other assets that are "interest in UK land" (see **11.203**); and

(c) assets (including overseas assets) that derive at least 75% of their value from UK land, (see **11.207**) but only if the holder has a substantial indirect interest in that land (see **11.214**).

(*TCGA 1992, s 1A(3) inserted by FA 2019, Sch 1, para 2*.)

11.5

Non-residents (including non-resident companies) were brought into the scope of CGT generally from 6 April 2019. However, CGT on non-residents (called NRCGT) has applied since 6 April 2015 in relation to UK residential properties and since 6 April 2013 in respect of some high-value residential properties (ATED-related gains – see **11.245**). Non-resident companies are chargeable to capital gains tax, not to corporation tax, but it is proposed to move such companies into the corporation tax regime from 6 April 2020. They are currently chargeable at the rate of 20%, even on residential properties, which is similar to the corporation tax rate. A non-resident company is also entitled to the indexation allowances on properties held at 31 December 2017 or disposed of before that date.

11.6

A special rule applies to sales and transfers within a group of UK companies. The price actually paid is ignored. Instead, the asset is treated as having been acquired by the transferee at a price that would secure that neither a gain nor a loss would accrue to the transferor (*TCGA 1992, s 171(1)*). This is normally the transferor's cost plus its indexation allowance. Broadly speaking, a subsidiary must be at least 75% owned by the group for it to be regarded as a group company. It was held in *DMWSHNZ Ltd v HMRC (2014 STC 1440)* that the settlement of a debt is not the transfer of an asset. This was significant because *TCGA 1992, s 171A* provides that where one group company sells an asset outside the group at a loss and another sells one at a profit in the same accounting period, they can jointly elect that the asset should be treated as having been sold intra-group immediately before the outside sale, thus enabling the gain to be set against the loss. In this case one company had sold its asset some years earlier in exchange for the issue of loan notes. The gain crystallised on the sale of the loan notes but did not become taxable until redemption and the company was seeking to set the past gain against a current loss. This decision was upheld by the Court of Appeal ([2017 STC 1076), which also pointed out that when the debt had been repaid, the obligation to pay had been discharged, so there were then no remaining creditor rights that could have been transferred to the issuer.

11.7

here is an anti-avoidance provision that will trigger tax on the gain at the time of transfer if the transferee leaves the group within six years of the transfer (*TCGA 1992, s 179*). Up to 18 July 2011, the gain was taxable in the company that left the group and was normally treated as a gain of the accounting period in which it left the group. Where a company leaves the group after that date by virtue of a disposal of the shares (of that company or its holding company) the gain is not taxed as such but is instead added to the consideration for the disposal (or a loss deducted from such consideration). Accordingly, if the gain on disposal is exempt under the substantial shareholdings exemption, this deeming also exempts tax on the gain on the asset transferred. The old rules continue to apply where the company leaves the group for any other reason. There is an exception where two or more associated companies leave the group at the same time and these include both the transferor and the transferee (*TCGA 1992, s 179(2)*). Companies are associated for this purpose only if together they would form a group, ie they are a sub-group within the main group (*TCGA 1992,*

s 179(2)). It has been held that the test of association must be held both at the time the asset was transferred and at the time that the transferee leaves the group (*Johnston Publishing (North) Ltd v HMRC (2008 STC 3116*). HMRC have said that they consider that where the companies are sister companies this means that the two companies concerned and their sub-group holding company must leave the group as a sub-group, but that it is not necessary for any other companies in the sub-group to do so (HMRC Brief 17.12.2008). From 19 July 2011, the requirement is that the companies must have been associated throughout the period from the transfer of the asset until immediately after they leave the group (*TCGA 1992, s 179(2)–(2ZB)*).

11.8

An individual can set a trading loss – but not a UK property business loss – against net capital gains of the same year of assessment to the extent that it cannot be relieved against income of that year (*ITA 2007, s 71* and *TCGA 1992, ss 261B, 261C*). Any excess trading loss can be set against capital gains of the following year if the trade is still being carried on in that year. Capital gains tax losses of earlier years must be utilised against capital gains in priority to trading losses and, unlike with brought forward capital losses, the claim for relief cannot be limited to preserve the benefit of the capital gains tax annual exemption. If the amount of capital gain available for offset is subsequently altered, eg because additional capital losses are established, the excess trading loss which this releases is converted into a capital gains tax loss – but ceases to be available for any relief at all if it is not utilised against future capital gains by the end of the year of assessment in which the trade ceases. The relief must be claimed at the time that a claim is made to set the trading loss against general income under *ITA 2007, s 64*, ie it cannot be claimed separately but the *section 64* claim must be expressed to extend to capital gains.

CALCULATION OF CHARGEABLE GAIN

11.9

A chargeable gain is calculated by deducting from the disposal consideration (or in some cases deemed disposal consideration) the allowable deductions specified by the legislation. The allowable deductions are limited to:

(*a*)

(i) the consideration (in money or money's worth) given by the taxpayer (or on his behalf) wholly and exclusively for the acquisition of the asset,

(ii) the incidental costs (see **11.14** below) to the taxpayer of the acquisition (or, if the asset was not acquired by him, eg he created it, any expenditure wholly and exclusively incurred by him in providing the asset),

(*b*)

(i) the amount of any expenditure ('enhancement expenditure') wholly and exclusively incurred on the asset by the taxpayer (or on his behalf) for the purpose of enhancing the value of the asset, being expenditure reflected in the state or nature of the asset at the time of the disposal,

(ii) any expenditure wholly and exclusively incurred by the taxpayer in establishing, preserving or defending his title to, or to a right over, the asset, and

(*c*) the incidental costs (see **11.14** below) to the taxpayer of making the disposal.

(*TCGA 1992, s 38(1).*)

11.10

For 2017/18 onwards, any amount taken into account by the taxpayer under *ITTOIA 2005, ss 96A* or *307E* (capital receipts under, or after leaving the cash basis) as the result of the operation of a deemed disposal under *ITTOIA 2005, s 96A* or *307F* is excluded from the consideration for the disposal of the asset (*TCGA 1992, s 37(1A)–(1C)* inserted by *F(No 2)A 2017, Sch 2, para 44*).

11.11

For income tax purposes only, where an asset was acquired before 1 April 1982 its market value at that date must be used in place of cost. A company can adopt that market value or can calculate the gains by reference to original cost if that is likely to be more beneficial (see **11.128**) (*TCGA 1992, s 35*).

11.12

Where an individual disposes of the whole or part of a business (or of his partnership share in a business) or shares in a trading company, entrepreneurs' relief, applies, provided that the necessary qualifying conditions are met. This relief is considered at **11.151** onwards.

11.13

The meaning of a business asset is outside the scope of this book. Broadly speaking it was one used as a fixed asset of a trade. The Special Commissioner in *Patel v Maidment (2004 STC (SCD) 41)* held that an activity of letting flats did not qualify as a business asset, on the basis of the statement by Vinelott J in *Griffiths v Jackson* (see **2.128**) that 'it is a peculiar feature of UK tax law that the activity of letting furnished flats or rooms, while it may be a business and, in this case a demanding and time-consuming business, it is not a trade'. Whether that is correct in all cases seems questionable. The main function of a hotel is letting rooms furnished. Furthermore, there is a Ministerial statement (see **2.138**) that *Griffiths v Jackson* does not establish that the fruits of holiday lettings were never to be taxed as a trade. Curiously though, between 6 April 2000 and 5 April 2008 a property which was let to a close trading company (even one wholly unconnected with the landlord) was a business asset. This was probably due to an accidental error in amending the wording of the legislation rather than a deliberate policy.

11.14

The incidental costs of the acquisition ((*a*)(ii) in **11.9** above) are limited to expenditure wholly and exclusively incurred by the taxpayer for the purpose of the acquisition, being either:

(i) fees, commission, or remuneration paid for the professional services of any surveyor or valuer, or auctioneer, or accountant, or agent or legal advisor;

(ii) costs of transfer or conveyance (including stamp duty); or

(iii) costs of advertising to find a seller.

11.15

The incidental costs of the disposal ((*c*) in **11.9** above) are similarly limited to expenditure wholly and exclusively incurred by the taxpayer for the purpose of the disposal being items within (i) or (ii) in **11.14** above, or:

(i) costs of advertising to find a buyer; or

(ii) costs reasonably incurred in making any valuation or apportionment required for the purposes of computing the chargeable gain, including in particular expenses reasonably incurred in ascertaining market value where required by *TCGA 1992*.

(*TCGA 1992, s 38(2).*)

11.16

Head (ii) in **11.15** will only allow a deduction for costs of a valuation to enable a best estimate of the gain to be calculated and returned. It will not extend to subsequent costs in negotiating the value with the District Valuer or the Shares Valuation Division, or in litigating the amount of the valuation (*Caton (dec'd) v Couch (1997 STC 970)*). Accordingly, it is sensible to ensure that as much of the work as possible is done to arrive at the initial valuation, rather than estimating this and leaving the formal valuation to be done later. In *HMRC v Blackwell (2017 STC 1159)* – a non-property case) the Court of Appeal held that the 'state or nature' of Mr Blackwell's shares had to be identified by reference to the rights and obligations which those shares conferred on a shareholder pursuant to the company's Articles of Association. That state or nature is unaffected by the making or subsequent discharge of an agreement with a third party that fettered his dealing with the shares. The same would apply to property. If an obligation is personal to the owner and not inherent in his property rights, a payment to discharge that obligation would not be deductible. It is possible though that such a payment could be a selling expense in such a case but HMRC might be expected to challenge that.

Non-Deductible Expenditure

11.17

If expenditure cannot be brought within one of the above heads, no relief will be obtainable for it. Furthermore, there is a specific prohibition on deducting any payment of interest – other than certain interest payments by companies (see **4.90** above) (*TCGA 1992, s 38(3)*). There is also a specific prohibition on deducting:

(*a*) any expenditure allowable as a deduction for income or corporation tax purposes in computing the profits or gains or losses of a trade; and

(*b*) any expenditure which, if the assets to which the CGT computation relates had, at all times, been used as a fixed asset of a UK trade, would have been allowable as a deduction in computing the profits of that notional trade.

(*TCGA 1992, s 39.*)

11.18

In the context of property, *s 39* can, in particular, deny relief in some common circumstances. Where a liquidator or receiver must pay arrears of rent to obtain a licence to assign a lease, the rent arrears cannot be deducted in calculating the gain arising on the assignment (*Emmerson v Computer Time International Ltd (50 TC 628)*). If the landlord will cooperate in such circumstances, an assignment of the lease with the arrears unpaid and the assignee undertaking to pay the arrears might be worth considering. It is possible that HMRC might contend that, as the liability to pay the rent was a liability of the assignor, the relieving him of this liability constitutes money's worth, and thus the payment of the arrears by the assignee is part of the consideration received by the assignor for the assignment. If the assignee were to enter into an agreement with the landlord under which the landlord waived the arrears in consideration of a payment to him by the assignee of the same amount, it would be difficult for HMRC to seek to tax this on the assignor. However, the assignee might find difficulty in bringing the payment into the categories of allowable deduction on a future disposal by him. It may be that it is a payment to acquire a separate asset, a right to take an assignment of the lease, which merges with the lease when the assignment takes place – so that *TCGA 1992, s 43* (assets derived from other assets) would treat the payment as part of the cost of acquiring the lease itself.

11.19

Where a person refurbishes a property prior to its disposal, a large part of the cost is likely to be repairs which, being of a revenue nature, would be excluded from CGT relief. Where a person carries out repairs on, or shortly after, acquiring a property and the cost of such repairs is excluded from being a deductible item under the UK property business rules, the amount disallowed should be claimed for CGT purposes as enhancement expenditure. However, the UK property business rules that applied before 6 April 1995 for income tax and 1 April 1998 for corporation tax differed from that laid down by the courts in relation to trading income (see **9.3** above) so, in theory at least, it is possible that expenditure which was not repairs under the property business rules would also be excluded from capital gains tax relief because of the different test propounded by *TCGA 1992, s 39(2)*. Where a seller would not be able to obtain a deduction for dilapidations, but the purchaser would be able to treat the cost as enhancement expenditure, it may be worth considering whether the work might be undertaken by the buyer with an appropriate adjustment being made to the price.

RESIDENTIAL PROPERTY GAINS

11.20

The distinction between residential property and other is important because a gain on the disposal of a residential property is taxed at 28%, whereas that on a commercial or industrial property is taxed at the lower rate of 20%.

11.21

In most cases, whether or not a gain is on a residential property will be readily apparent. However, if the property was not residential throughout the period of ownership, the residential property gain is the fraction that the number of days on which it consisted of (or included) a dwelling bears to the number of days in the period of ownership (*TCGA 1992, Sch 1B, paras 2(1),(2)(5)* inserted by *FA 2019, Sch 1, para 15*). If there has been mixed use of the land on one or more days, the amount of the residential gain must be adjusted on a fair and reasonable basis to take account of the mixed use on those days. There is mixed use for this purpose on any day on which the land consists of:

(a) one or more dwellings; and

(b) other land.

(*FA 2019, Sch 1B, para 2(1)(3)*.)

11.22

If the land was acquired before 1 April 1982, the period prior to that date is ignored in calculating the period of ownership. Similarly, for a non-UK resident, the part of the period of ownership prior to 6 April 2015 is ignored (*TCGA 1992, Sch 1B, para 2(6)*). If different interests in the land were acquired at different times, the entire interest disposed of is regarded as having been acquired at the time that the first interest was acquired (*TCGA 1992, Sch 1B, para 2(7)*).

Example 11.1

On 6 April 2012, Joe bought a house with a field attached. The field had previously been used to graze horses. Joe let the field to a neighbouring farmer until 5 April 2018. After that, he incorporated it into his garden. Joe sold the house on 5 April 2019.

The field is mixed use land from 2012 to 2018. After that, the whole of the property is residential.

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