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## **Basics of Capital Gains Tax (CGT)**

This summary is intended to outline some of the basics of CGT. The information contained herein should not be taken as an exhaustive authority on all aspects of Capital Gains Taxes, but we hope you will find the points mentioned interesting and informative.

A gain is an increase in value. You normally only have to pay Capital Gains Tax (CGT) when you no longer own an asset i.e. when you have disposed it or you receive a capital sum from your ownership of an asset.

**Chargeable Gain:** You may have a chargeable gain when,

- ❖ you dispose of an asset, or
- ❖ you derive a capital sum from your ownership of an asset

**Disposal:** A disposal occurs when you

- ❖ sell an asset
- ❖ give away an asset, or
- ❖ exchange one asset for another asset

**Date of Disposal:** If you dispose of an asset under a contract, the date of disposal is usually the date of the contract. However, if the contract is conditional i.e. it contains one or more conditions which have to be met before it becomes binding – the date of disposal is the date on which the last of the conditions is met.

If you do not make the disposal under a contract, other rules apply. For example, if you give away an asset, the date of disposal is the date on which you make the gift.

**Disposal Proceeds:** In most cases, the disposal proceeds is the amount you actually receive for disposing of the asset, including

- ❖ cash payable now or in the future
- ❖ the value of any asset you receive in exchange for the asset you have disposed of
- ❖ the value of a right to receive future payments which are uncertain and depend on future events.

In certain circumstances, you may be treated as disposing of an asset for an amount other than the actual amount (if any) that you receive.

**Acquisition Costs:** Usually, these are the actual amounts you paid to acquire the asset. If you bought the asset, this will be the purchase price you paid. If you created the asset yourself, this will be the capital expenditure you incurred in creating the asset. In certain circumstances, you may be treated as having acquired an asset for an amount other than the actual amount (if any) that you paid for it.

**Indexation Allowance:** This is an allowance, which reduces gains for the effects of inflation. It only applies to assets you acquired before April 1998. Indexation cannot create or increase a loss. If indexation would turn a gain into a loss, the result is capped

at zero – that is, there is no gain or loss. You work out the indexation allowance by multiplying the amount you spent by the indexation factor.

**Taper Relief:** Taper relief reduces a chargeable gain after losses, based on the period for which you held the asset before disposing of. The relief is given after all other reliefs and allowable losses. The amount of the reduction depends on

- ❖ how long you held the asset (the qualifying holding period), and
- ❖ whether the asset was a business asset or a non-business asset.

**Annual Exempt Amount:** Every individual has an annual capital gains tax allowance; gains below the allowance are exempt from tax. The annual exemption amount for individuals, trustees of settlements for the disabled, and personal representatives of the estate of a deceased person is £8,800 in 2006-07.

**Rate of CGT:** You have to pay CGT on the amount chargeable to CGT. How much CGT you pay depends on your overall income. Your total taxable gains are added to your taxable income for the year and treated as the top part of that total. The gains are then charged to CGT at the following rates (2006-2007 tax year):

- ❖ 10 per cent where they fall below the starting rate limit for Income Tax (£2,150)
- ❖ 20 per cent where they fall between the starting rate and basic rate limits for Income Tax (£2,151 to £33,300)
- ❖ 40 per cent where they fall above the basic rate limit for Income Tax (£33,301 and above)

*The content of this article is based on the tax legislation in operation at the time of publication, which may subsequently have changed. Readers should not take specific action based on this summary without first consulting the statute and regulations or seeking advice from a qualified professional.*

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