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# UK Capital Gains Tax and the Second Office of Tax Simplification Report

The Office of Tax Simplification (OTS) released its second report on capital gains tax (CGT) in May. Unlike the first report, which prompted endless press coverage about the likelihood of rising CGT rates, the second report seems to have quietly slipped by. Changing legislation, specifically around tax is a constant investor fear. In the US, President Biden has proposed changes to CGT and this has put possible changes to UK CGT back on some people's radar. We are asked about taxation issues a lot, especially CGT since the majority of the Fundsmith equity fund return will be via increases in capital value over the long term. This article may be useful to put investors' concerns in context.

## Press speculation

Before most Budgets it is common to see headlines about potential changes to taxation. Such headlines can appear at any time though and these are usually worded in such a way to cause maximum consternation and attention. The Times newspaper, following the publishing of the first OTS CGT report in November 2020, ran the sensationalist headline, 'Middle class facing £14bn capital gains tax raid on investments.' And many other publications repeated the £14bn figure.

What should an investor do when faced with such a headline? The obvious first answer is: nothing, until you have understood if there is any truth in the headline.

The first OTS CGT report was a long read (135 pages) but clearly stated the following, *'A rough static costing suggests that alignment of Capital Gains Tax rates with Income Tax rates could theoretically raise an additional £14 billion a year for the Exchequer. This reflects the fact that the vast majority of Capital Gains Tax by value comes from higher and additional rate taxpayers.* ***However, it is clear that nothing like this amount would be raised in practice****, due to behavioural effects (such as people delaying disposals) and other changes that might be made in parallel (such as allowing for inflation.).'* (Our emphasis added).

The OTS clearly did not think anything like £14bn could be raised and many of the report recommendations required significant changes to how CGT would be administered by HMRC. The OTS said they would detail their administrative recommendations in a second report which they would release in 2021 (with no publication date given at that time). Despite the second report not appearing pre-Budget, speculation was still rife ahead of it that changes to CGT were highly likely. It really did feel that no one doing the reporting had actually read the first report! Would the Chancellor really have announced such broad changes without knowing how they could be implemented, i.e. without having the second report?

> The first OTS CGT report *suggests that alignment of Capital Gains Tax rates with Income Tax rates could raise an additional £14 billion a year for the Exchequer. However, it is clear that nothing like this amount would be raised in practice.*

## HMRC statistics for CGT

HMRC statistics show record receipts from CGT in 2020/21 at £10.61bn.

A good question to ask is, "Would aligning CGT rates with income tax rates actually bring in extra revenue (the main point of any increase, surely) or would it risk actual receipts going into decline?" Consider some facts from the Capital Gains Tax statistics for 2018-19 released by HMRC in August 2020 (the OTS used the 2017-18 figures in their first report).

- 40% of CGT paid came from those who made gains of £5 million or more. This group (roughly 2,000 people) represents less than 1% of CGT taxpayers (of which there were 276,000).
- Roughly 6,000 individuals reporting gains of £500,000 or higher also had taxable income above £150,000, the additional rate threshold for Income Tax.

As you can see, a very small number of taxpayers paid a sizeable chunk of the total CGT receipts. When looking at the income for those reporting sizeable gains, we can also see a small group of people would have paid a large amount of CGT AND income tax. The data suggests these people are likely fairly wealthy, probably well advised and could easily take their wealth elsewhere (i.e. abroad) if they felt unfairly targeted. If this were to happen, then as well as losing CGT receipts, there could be lost income tax receipts as well. This type of data was in the OTS report but got no press coverage (that we saw anyway). We point out these facts (that the media seem to ignore) to show what a delicate tightrope Mr Sunak is walking here.

One final statistic from HMRC and something acknowledged in the first OTS report before we move on.

- Just over a quarter of CGT **paid** came from CGT disposals that qualified for Entrepreneurs' Relief (ER). ER was claimed by 46,000 taxpayers on £27.7 billion of gains in 2018-19. Gains from business sales represented close to half of all gains.

The lifetime limit for Entrepreneurs Relief (ER) was reduced drastically in the 2020 Budget (£10m down to £1m). If business owners continue selling businesses at the rate and size they have been over the last 6 years, the March 2020 reduction in ER means that future CGT receipts will already be significantly higher. Without any further changes, this group will see the majority of gains taxed at 20% as opposed to 10%. It can be argued that 20% is a low tax rate so if this group's behaviour alters drastically (to avoid an increased 20% rate), that may point to even bigger behavioural shifts if the top rate actually became 45%. Remember, gains from private business sales represented close to half of all reported gains, so the actions of this group will be important with regards to future CGT receipts. Again, it's a fine line between policy decisions that manage to increase tax receipts and those which cause taxpayers to alter their behaviour to the extent that tax receipts stagnate or drop.

### The second CGT report

One of the most notable aspects of report one was the difficulties in administering collection of CGT if many of the recommendations were enacted, e.g. the annual exempt amount being reduced to £2,500.

That change would require around 360,000 extra people to report gains annually, 240,000 of whom would have to enter self-assessment. This would go against another 2015 government/HMRC objective, namely the end of self-assessment and tax returns (search HMRC - Making Tax Easier: The end of the tax return). Currently, gains can be reported through the 'real time' CGT service. However, in 2018-19, only 1,670 people elected to use this service.

The report recommends the government move ahead with a 'Single Customer Account' (an improved mixture of the Personal Tax Account and real time reporting) to collect increased revenue from its suggested CGT changes. This is a part of the move to "Making Tax Digital", adverts for which you may have seen on TV. Making Tax Digital is part of a digitisation plan running to 2030 and is currently concentrating on businesses and VAT – no time frame is known for when CGT may be integrated into the process.

Report two from the OTS has not said anything that points to CGT being changed in any radical way anytime soon. Add in the statistical information above about where most of the CGT paid comes from and you may feel better placed to decide if radical changes to CGT are likely. As Edward Troup, a former permanent secretary at HMRC has been quoted as saying "In government you should only embark on serious tax reform **if you can raise serious money**". (Our emphasis added). There appears to be a huge amount of work to be done if many of the original recommendations from last November are to see the light of day.

**If you're still worried about rates of CGT going up, we close with three simple reminders:**

1. **Only hold quality investments you'd be happy holding forever, where you understand why their value likely appreciates over time. If you're not forced to realise gains from changing investments, higher tax rates become less of an issue.**
2. **The annual exempt amount for capital gains tax (£12,300 in 2021-22) is a use it or lose it allowance. Appropriate use of the allowance over time benefits long term returns.**
3. **If you haven't already done so, use your 2021-22 ISA allowance to shelter all future gains from CGT.**

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