

The Taxing Wealth Report 2024

Every politician's guide to
"How to pay for it".

Capital gains tax reforms: Reducing the annual exempt amount for capital gains tax

Brief Summary

This note suggests that:

- The capital gains tax annual exempt amount should be reduced from £6,000 per annum to £1,000 per annum.
- Since the exempt amounts that might be earned from trading and property activity within income tax law are now £1,000 per annum it makes sense that the same limit be used for capital gains tax purposes.
- The administrative burden on a person making capital gains exceeding £1,000 a year can be no higher than those on the person making trading or property income exceeding £1,000 a year when it comes to preparing a tax return and as such this request is administratively reasonable.
- It is likely that this proposal will not only promote horizontal and vertical tax equity but that it will also reduce the incentive to avoid tax and increase tax revenues by £0.4 billion per annum, and potentially somewhat more.

¹ This note forms a part of 'The Taxing Wealth Report 2024' published by Finance for the Future LLP, which is UK LLP number OC329502, registered at 33 Kingsley Walk, Ely, Cambridgeshire, CB6 3BZ. See <https://www.financeforthefuture.com/taxing-wealth/>. This note was written by Richard Murphy FAcSS FCA FAIA (Hon), Professor of Accounting Practice, Sheffield University Management School, who is a director of Finance for the Future LLP. © Finance for the Future LLP 2023

The Taxing Wealth Report 2024 is a joint project between:

Finance for the Future

and



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<p>The proposal</p>	<p>To reduce the capital gains tax annual allowance or exempt amount to £1,000 per annum to match the equivalent exempt sums allowed for trading and property income within income tax.</p>
<p>Reason for the proposal</p>	<ol style="list-style-type: none"> 1. To improve the horizontal equity of taxation, which is currently undermined by the availability of an additional exempt amount or allowance for capital gains enjoyed by UK resident taxpayers. 2. To increase the prospect of the vertical equity of taxation in the UK which is heavily dependent upon the creation of improved horizontal tax equity. 3. To reduce the tax spillover effect that having an annual exempt amount for capital gains tax creates. 4. To reduce the rate of tax avoidance in the UK. 5. To consequently improve the rate of tax compliance in the UK. 6. To raise modest sums in additional tax revenues.
<p>Estimated tax that might be raised as a result of the recommendation made</p>	<p>The behavioural response to this recommendation cannot be known.</p> <p>The recommendation should end the practice of tax planning to make use of the annual exempt amount for capital gains tax purposes which has been commonplace until recently and which will not be worthwhile once this change has taken place.</p> <p>Based on HMRC data it is suggested that this change might raise additional revenue of £0.4 billion a year but it has to be accepted that the true impact cannot be known in advance and may be significantly higher.</p>
<p>Ease of implementation</p>	<p>Simple.</p>

Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required.	Short.

Background

Capital gains tax was introduced in the UK in 1965. As was made clear by the Rt Hon James Callaghan MP, the Chancellor of the Exchequer at the time, the aim was to ensure that income could not be recategorised as capital gains and so escape from either the income tax system or fall out of taxation altogether. The tax was as a consequence always as much an anti-avoidance measure as it was a revenue-raising tax.

The tax rate in operation from April 2020 to April 2024 have been as follows:

	From 6 April 2023	From 6 April 2020 to 5 April 2023
Standard rate (basic rate taxpayers)	10% / 18%	10% / 18%
Higher rate (higher and additional rate taxpayers)	20% / 28%	20% / 28%
Business asset disposal relief (Entrepreneur's relief) effective rate	10%	10%
Annual exemption:		
Individual	£6,000	£12,300
Trusts	£3,000	£6,150

Where two rates of tax are shown the lower one is the rate charged on the disposal of all assets except properties and the higher one is that due on property.

Another proposal within the Taxing Wealth Report 2024 addresses issues relating to the rates of tax at which capital gains are charged. This recommendation relates to the annual exemption made available for the purposes of this tax.

It will be noted that the annual exemptions for this tax were reduced from 6 April 2023. In the Autumn Statement of 2022 the following was noted² (references to other measures having been edited out):

5.21 Capital Gains tax Annual Exempt Amount - The government will reduce the Capital Gains Tax Annual Exempt Amount from £12,300 to £6,000 from April 2023 and to £3,000 from April 2024. These measures will raise over £1.2 billion a year, from April 2025. The government will legislate for these measures in Autumn Finance Bill 2022.

It is not clear how these sums were estimated.

The reduction in this exempt amount was welcome: it helps achieve the objectives noted above. However, it remains the case that each person also has a personal allowance for income tax as follows, and that this capital gains tax allowance is additional to this.:

Personal allowances	2023-24	2022-23
Personal allowance (PA)	£12,570	£12,570

That said, the income tax system does provide an exemption from a charge to that tax in the case of any person making less than £1,000 a year from either trading or property income (rent)³. If it is assumed that it is administratively worthwhile collecting tax on trading and property income exceeding £1,000 a year, then it must also be the case that it is administratively worthwhile collecting capital gains tax on gains above the same limit. That is the reason for the adoption of that limit in this proposal.

Recommendation

The annual capital gains tax exempt amount still remains additional to the annual exempt amount provided to any person for income tax purposes. Although the capital gains tax exemption has been reduced recently the disparity between the exempt amounts made available for income tax and capital gains tax purposes is illogical and as such still provides a person who enjoys the benefit of capital gains with a tax advantage over the person whose income is entirely derived from sources subject to income tax.

² <https://www.gov.uk/government/publications/autumn-statement-2022-documents>

³ <https://www.gov.uk/guidance/tax-free-allowances-on-property-and-trading-income>

Because an exemption of £1,000 is provided for trading and property income in income tax law it is now proposed that a similar sum be provided as the annual exempt amount for capital gains tax purposes. There can be no logical reason for a bigger difference.

It is not possible to provide a precise estimate of the taxation benefits arising from this change, which is anyway motivated more by a desire for tax equity and to reduce tax avoidance than it is by a desire for additional revenue.

According to HM Revenue & Customs⁴, increasing the exempt amount for capital gains tax by £500 a year might at present cost approximately £40 million in lost tax revenue a year. Extrapolating the number tenfold and in the opposite direction may not provide a very good estimate of additional revenue, but it is the best basis for estimating available. As such estimated revenue of £0.4 billion is suggested.

⁴ <https://www.gov.uk/government/statistics/direct-effects-of-illustrative-tax-changes/direct-effects-of-illustrative-tax-changes-bulletin-january-2023>