APT

Capital Gains Tax - The Wrinkles

A Trumped Up Tax Charge

Our tax system delights in imposing tax charges on occasions where no one's received any profits.

In this year's Budget they are adding another one, which is legislation to give statutory effect to the case law rule in "Sharkey v Wernher" which itself was a fine example of judicial dottiness dating from the 1950's. The rule said that, if you had something which you held as trading stock (in the case itself it was racehorses), but you take that stock out of the trading business and put it in another business which you own, you have to pay tax as if you had sold the stock for its market value.

More and more tax commentators had been saying, in recent years, that this rule violates not just common sense and accounting practice, but the law as well, as developed in quite a few more recent cases.

Now the Revenue don't like to see a chance for levying tax slip out of their grasp, and so they've quietly introduced this in the 2008 Budget as a statutory rule, which of course will always override common sense, case law etc.

This piece isn't so much about the Sharkey v Wernher rule, though, as about the reverse situation. Where you hold a fixed asset but you put it into a trading business as stock, a rule which has existed for a very long time treats that as being a "capital gain". Like many other imaginary gains, this is calculated as if you had sold the asset for market value.

An Unexpected Tax Charge for Property Developers

Most frequently this occurs where a property investor has had a property for some years which he has let out to tenants, but now decides to redevelop.

Believe it or not, in the absence of a special claim, he could end up paying capital gains tax on this before he has even sent in the JCBs!

If you are clued up enough to spot this danger, there is a claim that you can make which effectively "rolls over" this imaginary capital gain, so that it becomes part of the trading profit when you eventually sell the houses or flats that you have built.

This brings about an interesting tax planning dilemma, which is arguably different now from what it was prior to 6 April of this year.

Now that property investors are only paying 18% capital gains tax, this looks pretty attractive in comparison with rates of up to 40% income tax which is what trading profits suffer now. But the penalty is that the capital gains tax charge, if you don't claim to roll it over, comes now, and might be before you have received any sale proceeds from the ultimate development. If you are a company, in any event, the tax rate will not vary by very much in most circumstances, so a claim under this relieving provision would be a good idea.

A better idea still would be to avoid the profit accruing to the limited company, and there are ways of doing that which would probably take up the whole of the rest of this magazine if we were to try and explain them in detail!

Alan Pink FCA ATII is a specialist tax consultant at Alan Pink Tax. Alan advises on a wide range of tax issues and regularly writes for the professional press. Alan has experience in both major international plcs and small local businesses and is recognised for his pro-active approach to taxation and solving tax problems. Alan can be contacted on (01892) 539000 or email: alan@alanpinktax.com.
The information contained in this article is for general guidance on matters of interest only. The application and impact of laws can vary widely based on the specific facts involved. As such, it should not be used as a substitute for consultation with professional accounting, tax, legal or other competent advisers. Before making any decision or taking any action, you should consult an Alan Pink Tax professional. You can contact an Alan Pink Tax consultant on (01892) 539000.