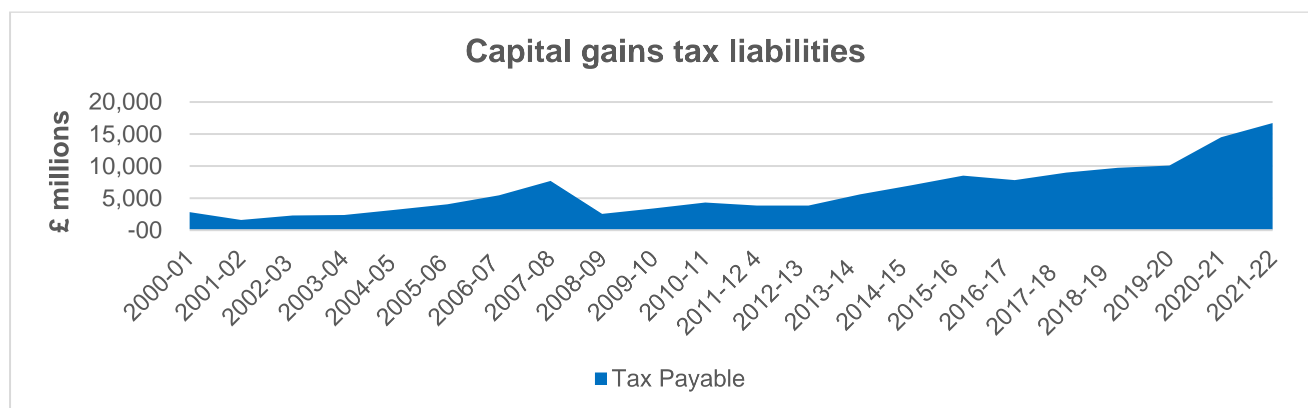
Capital gains tax on the rise – behind the headlines

Capital gains tax raised £16.7 billion in 2021/22, according to HMRC – a 15% increase over the previous year. But what lies behind these statistics?



Source: HMRC

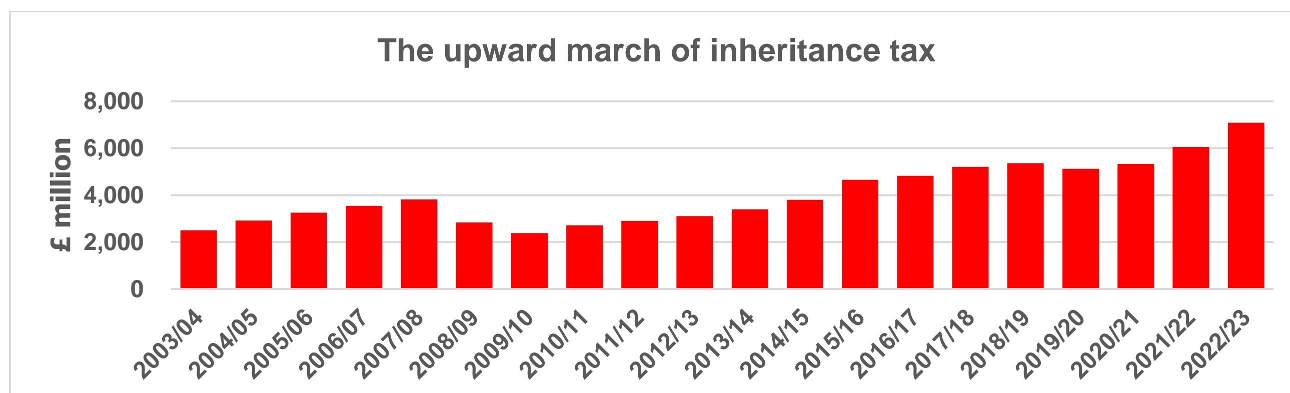
In early August media outlets reported that the government had raised a record amount of capital gains tax (CGT) last year. There was no doubting the numbers, as they came from the body collecting the tax – HMRC. However, the detail behind the statistics is in some ways more interesting than the headlines.

- In 2021/22, there were 370,000 individuals liable to CGT and 24,000 trusts. As HMRC notes, this is about 1% of the number of people who pay income tax.
- 45% of all CGT came from an elite group of taxpayers – in fact, less than 1% of all CGT payers – and members of this group all made gains of £5 million or more.
- Some of those realising capital gains in 2021/22 may have been trying to pre-empt an increase in CGT rates: up until the end of November 2021, there was a question mark hanging over the future levels of the tax. Rishi Sunak, Chancellor at the time, had commissioned and received two reports on CGT from the (now defunct) Office of Tax Simplification, but had been sitting on both, keeping taxpayers and their advisers in suspense.
- There was 56% jump in the taxable sales (and other disposals) of residential property in 2021/22 over the previous tax year, with a corresponding rise in tax liabilities. HMRC data shows that sales remained at virtually the same high level in 2022/23. This could well be confirmation of anecdotal evidence that smaller buy-to-let investors have been selling up in response to tax increases, additional legislative requirements and rising mortgage interest rates.

If your reaction to these figures is that you never pay CGT and never will, you may need to think again. In 2021/22, the annual exempt amount – the net amount of gains a person could make free of CGT in a tax year – was £12,300. In the current tax year, the exempt amount is £6,000 and from 6 April 2024 it will halve to just £3,000. When these changes were announced last November, HMRC estimated that in this tax year around half a million individuals and trusts could be affected. You too might become part of the CGT statistics.

So farewell then inheritance tax? Not so fast

Is Downing Street really planning to abolish inheritance tax?



Source: HMRC

Shortly before the so-called ‘silly season’ (Parliament’s summer recess) got underway, several newspapers carried stories that Downing Street was considering the abolition of inheritance tax (IHT) in an attempt to appeal to certain voters. The speculation did not last for long before the Uxbridge by-election result shifted the debate towards environmental concerns instead. However, it seems likely that the question of culling IHT will re-emerge as we head towards the next general election.

As the graph shows, receipts from IHT have more than doubled in the last ten years to over £7 billion. That growth has been aided by a combination of a nil rate band frozen at £325,000 since 2009 and, in recent times, rampant inflation. Even the introduction of the residence nil rate band in 2017/18 (now frozen at £175,000 until April 2028) made little impression on the upward march of IHT revenue.

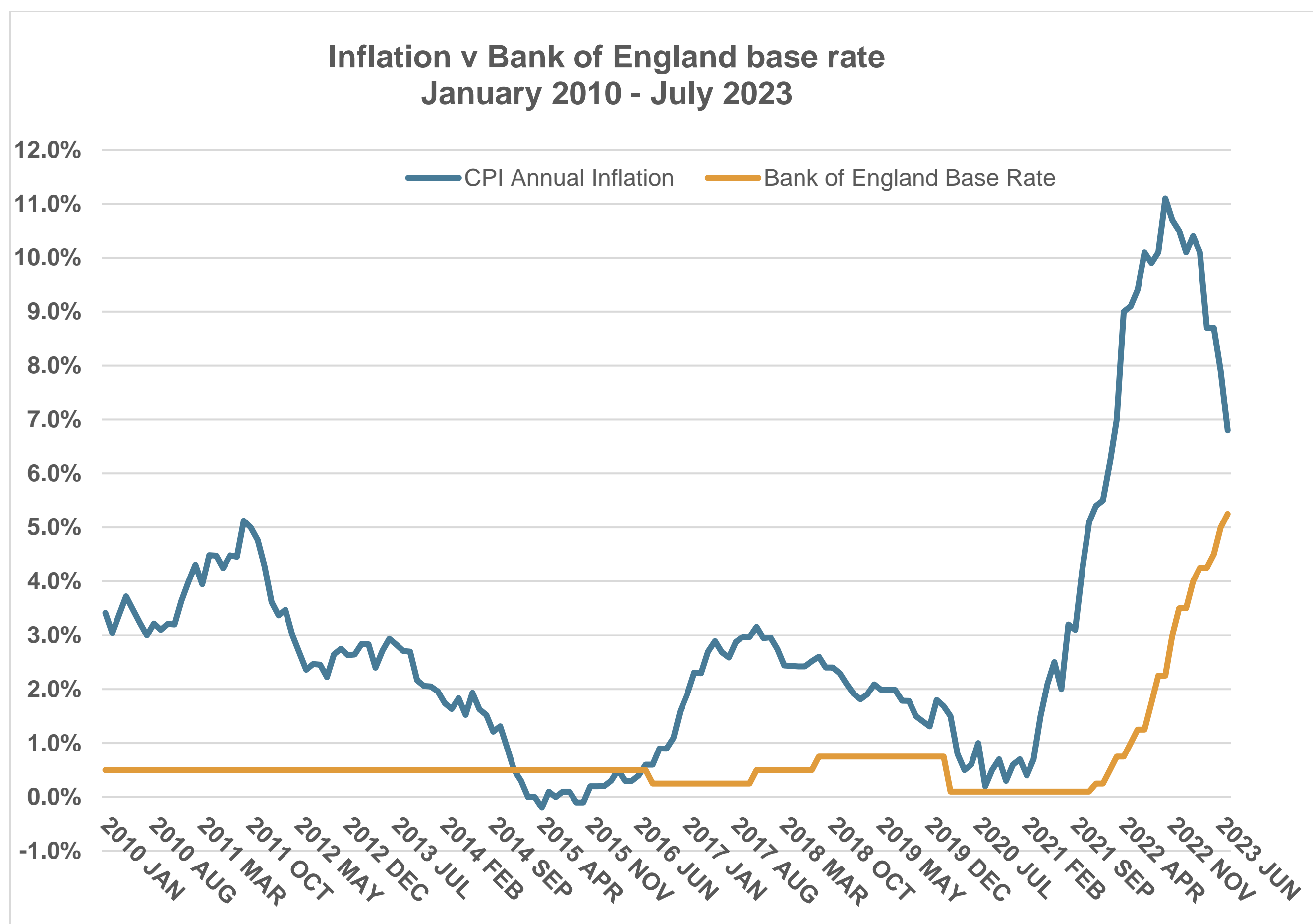
Inheritance tax is nothing new: it has existed in some form in the UK since 1780, the three most recent versions being estate duty (1894-1975), capital transfer tax (1975-1986) and inheritance tax (1986 to date). From the Treasury’s viewpoint, IHT, like its predecessors, is a particularly efficient tax. The number of estates that paid IHT in 2020/21 (HMRC’s latest statistics) is 27,000, with the average tax liability being £214,000.

This relatively small number of taxpaying estates and the large sums involved mean that HMRC can justify paying close attention to estate returns. A Freedom of Information response from HMRC in January 2023 underlined the impact of that scrutiny: in 2020/21 £326 million was “recovered” following over 4,000 “investigations”.

Given the current state of government finances, were IHT to be axed, then compensating for the lost income would entail adding about 1p extra on the basic rate of income tax or 4p on the higher rate. Alternatively, the standard VAT rate would need to go up to about 21%. If you compare how many people would be affected by such changes against the number who would benefit from the end of inheritance tax, the politics would seem to point towards continuing that 300-year plus tradition of estate taxes.

Time to get real on interest rates

As interest rates continue to rise, we need to consider why.



Source: Bank of England, National Statistics

Cast your mind back to July 2020. Covid-19 was creating massive social and economic disruption, reflected in a Bank of England interest rate of just 0.1% and instant access savings rates were little more than 1%. Three years later, the Bank of England rate had increased to 5% and some savings accounts were offering about 4.4%. Which was the better time to have cash on deposit?

The obvious answer would be July 2023, but there is a case for saying that July 2020 was in fact better for savers. The reason is simple: inflation. In July 2020, CPI inflation was running at 1.0%, whereas in July 2023, it was 6.8%. One way investment professionals look at interest rates is to take the nominal headline figure and subtract the going rate of inflation to arrive at a 'real' interest rate. Do that, and July 2020 delivered a very small positive real interest rate (1.1% - 1.0% = 0.1%), while July 2023 had a negative 'real' rate of over 2% (4.4% - 6.8% = -2.4%). When real rates are below zero, the message is that inflation is eroding your cash quicker than accumulating interest is growing it.

Tax has been ignored here to keep things simple, but tax too has become much more relevant to savings interest. The £1,000 personal savings allowance for basic rate taxpayers covered interest from a £100,000 deposit when rates were at 1%: now at, say, 4%, the corresponding figure is £25,000 and for higher rate taxpayers those cash figures halve. As the graph shows, since the start of 2010, the Bank of England's base rate has rarely been higher than inflation. Although easy access rates do not precisely match the Bank's rate, generally the two do not move far apart. So, since 2010, instant access accounts have lost their savers buying power, even with all interest reinvested. While interest rates are higher now than in the 2010s – and gaining plenty of attention – inflation is higher still.

The unhappy mathematics of real interest rates do not mean you should avoid cash deposits at all costs. Beyond the obvious need for rainy day money there are plenty of other reasons to retain some readily available funds earning interest. However, the more of your wealth that you hold on deposit, the more you must have good reasons for doing so.

Do you know your OEICs from your ETFs?

Investment funds come in a variety of formats and acronyms – the differences are worth knowing.

The days of individuals largely owning UK shares have long passed. The latest National Statistics data shows that in 2020, only 12% of shares were held by individuals. One reason behind that level has been the growth of investment funds – sometimes called collective funds – which pool capital from a range of investors. This approach offers a much greater diversification of holdings than most individual investors could achieve.

In the UK there are now three main types of collective funds vying for the private investor's attention: unit trusts, open-ended investment companies (OEICs) and exchange traded funds (ETFs).

Unit trusts have been around since 1930s and were once the dominant type of investment fund. As the name suggests, their structure is based around a trust, with investors owning 'units' in the trust in proportion to their investment. The trust is open-ended, allowing it to create more units as new investors arrive or cancel units as investors cash in and leave.

OEICs are in some ways the successors to unit trusts, although many unit trusts still exist. Instead of a trust-based structure with unitholders, the OEIC is a company-based structure with shareholders. Many EU-based funds and US mutual funds have a very similar structure to OEICs, which first appeared in the UK in 1997. For the individual investor, OEICs look virtually identical to unit trusts, with the same tax treatment and regulatory framework. As with the unit prices of unit trusts, OEIC share prices are calculated by the fund, based on the value of the underlying investments, with sales and purchases via the manager usually occurring at a fixed time each day.

ETFs are the (relatively) new kids on the block. They have a corporate structure like OEICs, but their shares are traded on the stock exchange, so can be bought and sold at any time the exchange is open. An ETF's share price is not calculated by the manager but decided by the market. In practice the market price of an ETF share normally very closely matches the value of the underlying investments.

The similarities between this trio of structures hide some subtle differences, making it best always to take advice before choosing an investment fund.

Deferring your state pension

You do not have to take your state pension at state pension age.

The current state pension age (SPA) – the earliest age at which you can draw your state pension – is 66. It will be gradually increased to 67 between April 2026 and April 2028. A further rise to 68 is due, probably between 2037 and 2039, but the confirmation of that timing has (conveniently) been delayed until after the next general election.

Most people draw their state pension as soon as it becomes available, which requires a claim to be made. If you do not make that claim, your state pension is automatically deferred until you choose to claim it. Up until then your deferred pension will increase every week you defer, provided you defer for at least nine weeks. The rate of increase is the equivalent of 1% for every nine weeks, which works out at just under 5.8% a year.

For example, if you defer the current state pension of £203.85 a week for 52 weeks you would receive an extra £11.82 a week once it started before adding the normal inflation related uplift. The increase is not compounded, so for two years' deferral the extra would be £23.64, and so on.

5.8% a year does not sound bad, but don't forget, your higher pension will be paid for a shorter period, as it started later. It can take a long time for the extra payments to overtake the loss of the full pension in the deferred period. For example, for a one-year deferral you will need to wait until you are about 81 before the total pension payments you have received are higher because of deferral, assuming 2.5% CPI inflation.

Nevertheless, there can be good reasons to defer. For example, if you are still working, your state pension would attract tax at your highest rate(s) which could be lower once you fully retire. There are other tax planning situations where being able to minimise income in a tax year can be useful, for example when cashing in an investment bond. Before you claim your state pension, make sure you take all your circumstances into consideration.