Use it or lose it

28th May 2024

To paraphrase Benjamin Franklin, taxes are a fact of life. But it is possible, with the right approach, to mitigate the impact.

When it comes to capital gains tax (CGT), having a proactive capital gains strategy is a key part of managing wealth and investments efficiently. At Edison, we review every client's capital gains position each year ahead of the tax-year end. The action we take is tailored to each unique circumstance, while recent cuts to exemptions make it even more important to be mindful of how and when to act.

CGT basics

First introduced in 1965, CGT is a levy on the profit generated from the disposal of an asset that has appreciated in value.

The term "disposal" broadly refers to the transfer of ownership of an asset, whether through sale, gift, exchange, or any transaction where the owner receives a capital sum from the asset.

One notable exception to this rule is transfers between spouses, which are deemed exempt by HMRC.

The "gain" element is essentially the difference between the proceeds on disposal of a chargeable asset and the cost of acquiring it in the first place, after accounting for factors such as any incidental costs of acquisition or disposal (for example, dealing fees).

Assets deemed 'chargeable' include personal possessions (excluding your car) valued over £6,000, property (except your primary residence in most instances), business assets, and assets such as investments which are held outside of tax-free wrappers.

Allowances

Each year, individuals and trusts receive a use-it-or-lose-it allowance known as the Annual Exempt Amount (AEA). Gains within the exemption do not incur CGT. In the 2024-25 tax year, this exemption stands at £3,000 for individuals and £1,500 for trusts.

Children, including minors aged under 18, are entitled to the full CGT exemption too.

Trusts, as well as higher and additional-rate taxpayers will pay CGT at 20% on gains in excess of their exemption, rising to 24% if they relate to residential property. Basic rate taxpayers pay 10% and 18%, respectively.

Why tax awareness matters

Given the use-it-or-lose-it nature of the annual exemptions, it's crucial to act before each tax year ends. Recent cuts to annual allowances – which more than halved in the 2023-24 tax year and halved again in the 2024-25 tax year – have made it easier to end up with a CGT bill.

Edison's approach

With all that in mind, here's a quick rundown of the work we've been doing in the past couple of months. Depending on personal circumstances and objectives, we consider three main strategies to mitigate CGT: (1) realising gains to use up the AEA; (2) realising losses to bring gain within the AEA and defer tax; (3) utilising losses brought forward from previous tax years to offset gains.

(1) Realising gains to use each year's allowance:

Where the annual capital gain is lower than the annual exempt amount, we look to realise additional capital gains. By examining each client's investments, we identified assets with unrealised gains that could be sold to bring the total realised gain as close to the allowance as possible.

(2) Realising losses to defer tax:

Where the annual capital gain is higher than the annual exempt amount, we look to realise losses. This action enables clients to reduce the tax burden by deferring tax on potential future capital gains, and, where possible, bring their capital gain position fully within the allowance.

(3) Utilising losses brought forward to offset gains:

Finally, for clients with capital losses brought forward from previous tax years, we sold assets with unrealised gains. Unused capital losses from previous tax years can be offset from realised gains over and above the AEA. This ensures the clients uses losses from previous tax years, in addition to making full use of the AEA.

Implementing

After conducting individual assessments of each client, we identified the necessary actions, if any.

This includes realising gains or losses, using brought-forward losses from previous years, and transferring assets between spouses.

Assets sold are replaced temporarily in line with HMRC's 30-day rule, which stipulates that a sale is only recognised for CGT purposes if not repurchased within the subsequent thirty days. After this period, portfolios are rebalanced back in line with their target allocation.

Ongoing tax strategies

There are lots of other ways to help mitigate the annual tax burden. These form part of our financial planning service, which aims to make sure more of our clients' wealth goes towards their future.

As mentioned briefly, transferring assets between spouses does not usually incur any tax charge. It can help to use allowances, or move assets where it is possible to more efficiently realise gains or losses (for example, when a spouse or civil partner is in a lower tax bracket).

It is important to make the most of tax efficient wrappers in the form of ISAs and SIPPs. These can help to shelter investments from potential tax charges. Capital gains are tax-free on all ISA and SIPP investments, no matter the size.

If losses in any tax year outweigh the gains, the net loss can be carried forward into the following tax years, provided they are recorded with HMRC.

To hear about these and other strategies in more detail, or how they may help you or your family, please call 020 7287 2225 or email hello@edisonwm.com.

You can read more about us, including our investment service, by visiting our website www.edisonwm.com.

Important Information

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This document does not constitute advice.

The value of investments and the income arising from them can go down as well as up and is not guaranteed, which means that you may not get back what you invested. Past performance is not necessarily a guide to the future.

Source: HMRC. Edison Wealth Management, 2024.

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