

FINANCE (NO. 2) ACT 2010

EXPLANATORY NOTES

Section 2 Schedule 1: Rates of Capital Gains Tax

Summary

1. [Section 2](#) and Schedule 1 change the rates at which capital gains tax (CGT) is charged. This replaces the single rate of 18 per cent for all gains (with gains qualifying for entrepreneurs' relief being reduced to deliver an effective rate of 10 per cent).
2. The rate of CGT for gains that do not qualify for entrepreneurs' relief will now be:
 - 18 per cent up to any unused amount of an individual's income tax basic rate band; and
 - 28 per cent for other gains, including gains of trustees and the personal representatives of deceased persons.
3. The 10 per cent rate for gains qualifying for entrepreneurs' relief remains, but is now delivered simply by charging those gains at that rate, and the lifetime limit for gains qualifying for the relief is increased from £2 million to £5 million.
4. The changes take effect for gains arising on or after 23 June 2010.

Details of the Schedule

5. Paragraph 2 of the Schedule replaces section 4 of the Taxation of Chargeable Gains Act 1992 (TCGA), which previously provided that all gains were chargeable to CGT at a rate of 18 per cent, and adds new section 4A.

Details of the revised [section 4](#) and the new section 4A of TCGA

6. Subsection (1) of the revised section 4 provides for the section to prescribe the rates at which CGT is chargeable, and that the section is subject to section 169N of TCGA (which provides rules for charging CGT on gains qualifying for entrepreneurs' relief).
7. Subsections (2) to (4) provide that the rate of CGT is 18 per cent, (subject to other provisions of the section), and that the gains of trustees and personal representatives, and individuals liable to income tax at higher rates, are to be charged at 28 per cent.
8. Subsections (5) to (9) have the effect that where an individual's taxable income for a tax year is less than their basic rate band, gains up to the amount of the unused portion of the basic rate band are charged at 18 per cent. Gains above that limit are charged at 28 per cent. Gains in respect of which entrepreneurs' relief is claimed, which are taxable at 10 per cent (see paragraph 13 below), are set against any unused amount of the basic rate band before other gains.
9. New section 4A supplements section 4 in cases where income tax liability is reduced by reason of certain reliefs in relation to life insurance policies, capital redemption policies and contracts for life annuities, or certain income of the estates of deceased persons. It ensures that these reliefs are taken into account in determining any unused amount

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of the basic rate band. Section 4A is modelled on, and has the same effect as, the old section 6 of TCGA which applied for tax years before 2008-09 when the rate of CGT was linked to income tax liability.

10. The revised section 4 and the new section 4A have effect for gains arising on or after 23 June 2010 (paragraph 12).
11. Paragraph 3 of the Schedule inserts a new section 4B into the TCGA. This section provides that a person whose gains for a tax year are chargeable to CGT at more than one rate may deduct any allowable losses and the annual exempt amount for that year in the way that produces the lowest possible tax charge. Existing legislation that limits the way certain losses may be set off continues to apply. New section 4B has effect for the year 2010-11 and later years (paragraph 13).
12. Paragraphs 4 to 8 amend the provisions of the TCGA that provide the rules for entrepreneurs' relief. Entrepreneurs' relief reduces the effective rate at which gains on disposals of certain assets are charged to CGT. There are two main changes. First, from 23 June 2010 entrepreneurs' relief is given by charging qualifying gains at a reduced rate of 10 per cent, whereas before that date the relief was given by reducing the amount of qualifying gains charged at the single rate of CGT prevailing at that time. Second, the lifetime limit on the gains eligible for relief is increased from £2 million to £5 million.
13. Paragraph 4 amends the description of entrepreneurs' relief in the introductory section 169H, to reflect the change in the way the relief is given.
14. Paragraph 5 amends section 169N of TCGA, which provides the mechanism for giving entrepreneurs' relief. The effect of the changes is that from 23 June 2010 gains in respect of which entrepreneurs' relief is claimed are charged at 10 per cent, up to an increased lifetime limit of gains of £5 million. Gains arising before 23 June 2010 that benefited from entrepreneurs' relief are taken into account in determining whether the lifetime limit has been reached.
15. Paragraphs 6 and 7 amend sections 169O and 169P of TCGA, to remove references to the reduction of the gain made under the previous rules for entrepreneurs' relief.
16. The changes made by paragraphs 4 to 7 of the Schedule have effect for disposals on or after 23 June 2010 (paragraph 14).
17. Paragraph 8 substitutes a new section 169R in TCGA. That section applies where shares are exchanged for qualifying corporate bonds (QCBs) (for example, on the takeover of a company) and a gain on disposal of the shares could have qualified for entrepreneurs' relief. QCBs are exempt from CGT. The main CGT legislation provides that the exchange is not treated as a disposal of the shares. Instead, a gain is calculated as though the exchange were a disposal, and comes into charge when there is a disposal of the QCBs.
18. Section 169R, as it stood before these changes, applied if a gain on the disposal of the shares at the time of the exchange could qualify for entrepreneurs' relief. It had the effect that, if a claim was made, then in computing the deferred gain that comes into charge on disposal of the QCBs, the deduction of 4/9 that gave the effective lower rate for entrepreneurs' relief should be taken into account, so that entrepreneurs' relief was effectively given.
19. The changes made by paragraph 8 have the effect that, if entrepreneurs' relief would be available on a disposal of the shares at the time of the exchange for QCBs, an election can be made for the gain not to be deferred but instead brought into charge at that time and the relief claimed. If no election is made and the gain is therefore deferred, it is likely that in almost all cases the gain will not qualify for entrepreneurs' relief when it comes into charge at a later date. The new rule has effect where the exchange of shares for QCBs takes place on or after 23 June 2010 (paragraph 15).

20. Paragraph 9 applies where an individual's gain on a disposal could qualify for entrepreneurs' relief and could be deferred because the individual invests, within a specified time limit, in shares qualifying under the Enterprise Investment Scheme ("EIS shares"). The deferred gain comes back into charge on the occurrence of any of a number of "chargeable events" (such as a disposal of the EIS shares). Under the entrepreneurs' relief rules as they stood before these changes, it was possible for a claim for entrepreneurs' relief to be made in respect of the gain, so that it was reduced by 4/9, and then for that reduced gain to be deferred against investment in EIS shares and come back into charge on the occurrence of a chargeable event.
21. Paragraph 9 modifies the rules for EIS relief following the change to the way in which entrepreneurs' relief is given. In future an individual may choose between claiming entrepreneurs' relief and paying tax on the gain at 10 per cent, or deferring the gain under the EIS rules and paying tax at 18 per cent or 28 per cent when it later comes into charge. Where a gain exceeds the £5 million lifetime limit for entrepreneurs' relief it will be possible to claim entrepreneurs' relief on the gain up to the limit and to defer the gain above the limit under the EIS rules. This change has effect where the gain arises on a disposal on or after 23 June 2010 (paragraph 14).

Amendments to Finance Act (FA) 2008

22. When entrepreneurs' relief was introduced in FA 2008 there were a number of transitional provisions which enabled entrepreneurs' relief to be claimed in respect of certain deferred gains that arose before 6 April 2008. In relation to both gains deferred as a result of an exchange of shares for loan notes, and gains deferred by investment in EIS shares or shares in a venture capital trust (VCT shares), it was possible to claim entrepreneurs' relief on the first occasion on or after 6 April 2008 when all or part of the deferred gain came into charge. Where such a claim was made, the whole of the deferred gain that had not come in to charge before 6 April 2008 was reduced by 4/9.
23. Paragraphs 10 and 11 amend those transitional provisions following the change to the way in which entrepreneurs' relief is given. They have effect in cases where none of the gains deferred as at 6 April 2008 has come into charge between 6 April 2008 and 22 June 2010, so that no claim for entrepreneurs' relief can have been made in respect of those gains.
24. Paragraph 10 applies where gains were deferred before 6 April 2008 in respect of an exchange of shares for QCBs. When any part of the deferred gain comes into charge on or after 23 June 2010, because of a disposal of all or some of the QCBs at that time, a claim for entrepreneurs' relief in respect of the deferred gain can be made under the transitional provisions in Schedule 3 to FA 2008. Where such a claim is made (and the other conditions for the relief were satisfied at the time of the exchange), the deferred gains are charged at the entrepreneurs' relief rate of 10 per cent. This revised rule applies where the first disposal of QCBs since 6 April 2008 takes place on or after 23 June 2010 (paragraph 16).
25. Paragraph 11 applies where gains arising before 6 April 2008 were deferred against investment in EIS shares or VCT shares. Where all or part of that gain comes into charge on or after 23 June 2010 because a "chargeable event" (see paragraph 19 above) takes place on or after that date, a claim for entrepreneurs' relief in respect of the deferred gain may be made under the transitional provisions of Schedule 3 to FA 2008. Where such a claim is made (and the other conditions for the relief were satisfied at the time the gain arose), the deferred gain is charged at the entrepreneurs' relief rate of 10 per cent. This revised rule applies where the first chargeable event since 6 April 2008 takes place on or after 23 June 2010 (paragraph 17).
26. If a claim under the FA 2008 transitional rules has been made because a disposal of QCBs (in relation to the rules in respect of exchanges of shares for QCBs) or a chargeable event (in relation to a deferral against investment in EIS shares or VCT shares) took place between 6 April 2008 and 22 June 2010, any part of the deferred gain that qualified for entrepreneurs' relief and has not come into charge before 23 June

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2010 will have been reduced by 4/9. When that reduced gain comes into charge on or after 23 June 2010, the reduced gain will be charged at the “new” rate of 18 per cent or 28 per cent.

Transitional provisions

27. Paragraphs 18 to 22 provide transitional rules for certain cases affected by the alteration in the rates of CGT part-way into the year 2010-11.
28. Paragraph 18 ensures that for 2010-11 gains arising before 23 June 2010 are charged at the single 18 per cent rate that applied before that date, and are not taken into account in determining which gains arising on or after 23 June 2010 are set against any unused amount of the income tax basic rate band.
29. Paragraph 19 provides a rule in relation to section 10A of TCGA. Section 10A provides that, where an individual ceases to be resident in the UK and then resumes residence within a specified time, certain gains that they realised during the period of non-residence are treated as arising in the year they again become resident. Where the resumption of residence is during 2010-11, all gains arising under section 10A are treated as arising before 23 June 2010, and are therefore chargeable at the single rate of 18 per cent.
30. Paragraph 20 provides a rule for individuals who are taxed on the “remittance basis”. This basis is available to individuals who are resident in the UK but are not domiciled here. One aspect of the remittance basis is that gains on the disposal of assets situated outside the UK are chargeable only when they are remitted (brought into) the UK.
31. Paragraph 20(1) provides that for individuals taxed on the remittance basis for 2010-11, gains remitted to the UK are treated as arising at the time they are remitted (so that the time of remittance determines whether the gains are treated as arising before 23 June 2010 or on or after that date). The provision is subject to sub-paragraph (2).
32. Paragraph 20(2) addresses the case where section 809J of the Income Tax Act 2007 applies so that a remittance is not treated as a remittance of the actual income or gains being remitted, but instead is treated as a remittance of other income or gains in accordance with a special rule. This can occur if an individual who elects for remittance basis has to pay a “remittance basis charge” of £30,000. Any gains treated under section 809J as remitted during 2010-11 are deemed to arise before 23 June 2010, so that they are chargeable at the single rate of 18 per cent.
33. Paragraph 21 deals with cases where section 86 of TCGA applies. Section 86 applies in cases where the trustees of a settlement are not resident in the UK, and the settlor of the settlement is resident and domiciled in the UK and has an interest in the settled property. The effect of section 86 is that the trustees’ gains of the year (net of losses) are effectively charged on the settlor. Paragraph 21 has the effect that where section 86 applies for 2010-11, all the gains chargeable on the settlor by virtue of that section are treated as arising before 23 June 2010, so that they are chargeable at the single rate of 18 per cent.
34. Paragraph 22 applies where trustees of a settlement are not resident in the UK and their gains are effectively charged on UK-resident beneficiaries who receive capital payments from the trust. The amount of such a charge is determined by “matching” capital payments received with trustees’ gains (net of losses). Paragraph 22 has the effect that where the receipt of capital payments in 2010-11 results in gains being charged to beneficiaries for that year, the gains matched with each capital payment are treated as arising when the capital payment was received. So gains matched with capital payments received between 6 April and 22 June 2010 will be chargeable at the single rate of 18 per cent, while gains matched with capital payments received on or after 23 June 2010 will be chargeable at 18 per cent or 28 per cent, dependent upon how much of the beneficiary’s income tax basic rate band is unused.

Background Note

35. Since 6 April 2008 capital gains tax has been charged at a single rate of 18 per cent. Gains in respect of which entrepreneurs' relief is claimed have been taxed at an effective rate of 10 per cent (up to a lifetime limit of qualifying gains of £1 million, increased to £2 million with effect from 6 April 2010). This effective 10 per cent rate was given effect by reducing qualifying gains by 4/9 and charging the balance at the single 18 per cent rate.
36. The changes made by Schedule 1 replace this single 18 per cent rate of CGT with effect from 23 June 2010.
37. Gains qualifying for entrepreneurs' relief will be charged at a new 10 per cent rate, instead of being reduced by 4/9 and charged at 18 per cent, and the lifetime limit on total gains eligible for relief is increased from £2 million to £5 million.
38. For individuals, the rate at which gains, other than gains qualifying for entrepreneurs' relief, are charged will depend upon the individual's top rate of income tax for the year. If an individual's taxable income is lower than the maximum of their basic rate band, gains up to the amount of the shortfall are charged at 18 per cent. Any other gains of individuals are charged at 28 per cent.
39. Gains of trustees of settlements and personal representatives of deceased persons are charged at 28 per cent.
40. Because different gains may be charged at different rates of CGT, there is a new rule that losses and the annual exempt amount (AEA) are deductible from gains in the order that gives the best result for the taxpayer. This will normally mean that losses and the AEA are deducted first from the gains potentially liable at the highest rate.
41. Because the changes to the rates of CGT take effect part of the way through the tax year 2010-11, gains arising between 6 April 2010 and 22 June 2010 are chargeable under the old rules at 18 per cent, with gains qualifying for entrepreneurs' relief being reduced by 4/9 before being charged. Gains arising on or after 23 June 2010 are charged under the new rules, as explained at paragraphs 36 to 39 above.
42. The rule for deduction of losses described at paragraph 39 will apply to all gains of the year 2010-11. This will normally involve losses and the AEA being deducted:
 - first from gains (other than gains qualifying for entrepreneurs' relief) arising on or after 23 June 2010, that are chargeable at 28 per cent or 18 per cent;
 - then from gains arising between 6 April 2010 and 22 June 2010 (including gains qualifying for entrepreneurs' relief that have been reduced by 4/9), that are chargeable at the previous single 18 per cent rate; and
 - finally from gains arising on or after 23 June 2010 that qualify for entrepreneurs' relief and are chargeable at the new 10 per cent rate.