



You raise me up; but for how much longer? CGT and the uplift on death

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The cost of the ongoing pandemic to the Exchequer is well documented. Late last year the OBR¹ forecast that over £270bn would be borrowed by the government in the nine months to December 2020, which figure could increase to over £390bn by the end of March 2021. In these straitened times (and as the spring budget hoves into view) we can anticipate that the government will scrutinise closely the opportunities for increasing the tax take. Given the recommendations made in OTS's recent first report into CGT, CGT could prove a ripe target for HMRC's plucking.

It is true that CGT provides relatively modest revenue. In the 2017-18 tax year £9bn of CGT was paid on reported net gains of £58.9bn, of which £0.6bn was paid by trustees on £3.5bn of trust gains (the remainder was paid by 265,000 individual taxpayers).² This compares with £180bn of Income Tax paid by 31.2m individual taxpayers over the same period. For those who pay CGT, however, the amounts can be substantial. The mean CGT liability was £32,000. This compared with a mean Income Tax liability of £5,800.

The most headline worthy recommendations of OTS's report concerned the interaction between the CGT and Income Tax regimes, and the possible closer

¹ See ONS's announcement of 22 January 2021 on public sector finances, UK: December 2020 (accessed at <https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/december2020>)

² Office of Tax Simplification, Capital Gains Tax review – first report: Simplifying by design, p. 20 (accessed at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/935073/Capital_Gains_Tax_stage_1_report_-_Nov_2020_-_web_copy.pdf)

alignment of rates of tax. One option obviously available to the Chancellor would be to raise CGT Rates to be in closer alignment with Income Tax rates. Another option clearly would be to reduce the annual exempt amount for CGT (which presently stands at £12,300).

OTS's report contains other noteworthy recommendations, however, which, if implemented, could have very profound impacts for taxpayers and advisors alike. One such recommendation is the possible abolition of the capital gains uplift on death either in respect of assets which benefit from favourable IHT treatment only, or more widely on all the assets in the estate.

To recap, at the moment, when a person dies there is no CGT liability on any unrealised gains on those assets. Further, the person who inherits those assets benefits because the base cost of each asset is deemed for the purposes of CGT to be the market value of that asset on the date of death. Accordingly, any previous gain (or loss) which accrued to, but was not realised by, the deceased is wiped out.

OTS points out the uplift has a 'lock in' effect. 66% of respondents to OTS's survey said that CGT was a barrier to passing on assets. Asset holders are often advised to retain the asset until death because of the CGT benefits. This can lead to stagnation of a business, say, while at the same results in differential treatment between *inter vivos* disposals and testamentary disposals.

The OTS proposes as a possible alternative a 'no gain no loss' approach, whereby a recipient is treated as acquiring the assets at the historic base cost of the person who has died. The OTS acknowledges that there would be administrative challenges with such an approach. That seems something of an understatement. How is an executor to value the gain to an asset held for a long time where perhaps records of acquisition might not have been kept by the deceased? To mitigate this problem OTS proposes a rebasing of assets to, say, 2000. Given that is now 21 years ago, however, it can be expected that this will still leave a plethora of difficulties in practice: many individuals will have acquired assets after that date and not have kept records at this remove of time. Headaches for executors (and beneficiaries) loom.

There is also the obvious risk, adverted to by the OTS, that abolition of the uplift on death might result in a new distortion in favour of lifetime transfers. Two possible mechanisms are proposed to counter this: either the value of the estate for IHT purposes could be reduced by the amount of CGT that would have been charged assuming the asset had been sold on death; or alternatively the full amount of IHT could be paid but with a CGT credit applied against eventual sale of the asset.

One wonders how realistic these mitigation strategies are either practically or as a matter of principle. Increasing the immediate IHT burden raises obvious cash flow problems for estates, while the application of credit creates accountancy and future planning issues for beneficiaries.

As a matter of principle, it would be tempting for the government simply to avoid this issue entirely by treating IHT and CGT on death quite separately (as the OTS adverts is indeed a possibility), resulting in an increase to the overall tax burden. Yet IHT is already one of the most reviled taxes. Taxpayers structure their affairs to try to minimise their estate's liability to this tax.

If CGT were to be payable on the assets held at death (whether immediately by the estate or upon a subsequent disposal by the estate or the beneficiaries), one rather expects that asset holders will during their lifetimes focus even more energetically on the sort of estate planning that is already such a rich stream of work for private client advisors. Where assets will not benefit from IHT relief, there will be yet more incentive for those holding assets to try to divest themselves of assets more than 7 years before death. Where assets will continue to benefit from IHT relief, then a testator will have to weigh up the IHT savings against the liability to CGT. Given the current rates of CGT liability, and the fact that CGT is charged on gain not asset value, it would presumably often be in the interests of asset holders to retain the assets. Depending on the rates of CGT and/or the domicile of the testator, however, *inter vivos* disposal might be preferable.

All of these issues would need to be grappled with if the uplift on death for CGT purposes was to be abolished or restricted. Accordingly, while the treatment of

capital gains on death is an issue which is ripe for reconsideration, its technicality and nuance with IHT render it rather unlikely in this author's opinion that any concrete announcements will be made in the forthcoming Budget. It is perhaps more likely that eye-catching changes to the rates of CGT and/or reductions to annual allowances will be made. Nevertheless, expect to see the Exchequer scrutinising closely the uplift on death in these troubled economic times.

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