

Capital Gains Tax and the changes.

Alistair Darling is only the latest in a long line of chancellors to grapple with the problem of pinpointing gains and to prevent people avoiding tax on what is, in effect, income.

Back in 1962, the Tory chancellor Selwyn Lloyd was the first to introduce what he called "a speculative gains tax" (at income tax rates then up to 80%) on shares sold within six months or of land sold within three years of acquisition.

When Labour came to power, Jim Callaghan's first budget in 1965 extended the principle to longer-term capital gains, which were to be taxed at a flat rate of 30%.

During the 1970s successive Labour and Tory Chancellors tinkered with the rates, modified the conditions and attempted to block loopholes with varying degrees of success.

Indexation

One of the main complaints was that the tax took no account of inflation and that so-called "gains" were actually illusory.

It was Sir Geoffrey Howe who decided in his 1982 budget to allow future indexation of capital gains for all assets held on 31 March 1982 or subsequent date of acquisition.

“There is no doubt that the system is hugely”

This meant that £1,000 of shares could be revalued to (say) £1,300 if the Retail Prices Index (RPI) went up 30%.

These rules remained in place until March 1998 when the Chancellor, Gordon Brown decided to introduce "taper relief".

This reduced the amount of capital gains tax payable depending on how long an asset had been held.

In broad terms, an asset held for three years or more would qualify for a discount of 5% a year on the individual's marginal income tax rate.

In other words, from the third year onwards a 40% rate taxpayer would pay two percentage points less each year - meaning that after 10 years the effective rate of CGT would be 24%, the maximum discount available.

Complicated

The current 2007-2008 tax year is the first time the maximum taper relief can apply for disposals of assets held on or before 1998.

There is no doubt that the system is hugely complicated, not least because taper relief is applied on top of indexation.

This can double the original acquisition cost and may need reference to records and calculations back to March 1982.

But the principle was always to tax long-term holders of shares and investment property at a lower rate than short-term speculators.

It was this principle which the Labour government originally adopted in 1965 - and which now appears to have been turned on its head.

Speculators

Now it could be argued that Alistair Darling has compromised fairness in the interest of simplicity, by proposing a flat rate of 18% to capital gains regardless of how long an asset has been held.

Certainly some - such as private equity shareholders - will pay more. But so will entrepreneurs, who have built up small businesses over many years and now wish to retire.

“ Speculators who Gordon Brown believed should wait ten years to enjoy the full ”

Then there are those with a portfolio of shares held for maybe 15 or 20 years - after all, investors are often encouraged to take a long term view - who will find themselves lumped together with second home owners and short-term speculators, who have profited hugely from the boom in buy-to-let properties.

To add insult to injury, it appears that those who held shares or investment property prior to 1998 will also lose the benefit of up to 15 years of indexation.

Speculators who Gordon Brown believed should wait ten years to enjoy the full effect of taper relief will scarcely believe their luck.

From 6 April 2008, it seems they will be able to cash in with an 18% levy on the profit, less than half what they might have to pay today.

They may well be tempted to do so while the going is good.