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The information in this leaflet is a general description only and specific advice should always be obtained before taking any action.

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CHARTERED ACCOUNTANTS

CAPITAL GAINS TAX

INDEXATION ALLOWANCE

ANSTRUTHER
CUPAR
PITTENWEEM
ST ANDREWS



CAPITAL GAINS TAX INDEXATION ALLOWANCE

The calculation of a capital gain is based on the difference between the sale proceeds of a capital asset and the initial cost price/value of the asset plus any relevant allowable expenditure plus indexation. The indexation allowance allows the cost of acquiring the asset and improving the asset to be adjusted for inflation.

Individuals, partners, trusts and companies can claim indexation allowance. However in the case of individuals and trusts no indexation allowance is given after 6 April 1998 when taper relief was introduced.

Indexation is calculated using a formula based on inflation between the date of purchase (or March 1982 if held then) and the date of sale.

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CAPITAL GAINS TAX INDEXATION ALLOWANCE

Key Points

1. Indexation Allowance adjusts the total cost of an asset for the effect of inflation (see example 1).
2. Indexation Allowance cannot be used to create a Capital Loss (see example 2).
3. Indexation Allowance on a partial disposal of an asset is calculated after the relevant expenditure has been apportioned.
4. Indexation Allowance cannot be claimed by individuals after 6 April 1998. From this date taper relief applies. It will eventually replace indexation allowance.
5. Taper relief reduces a chargeable gain by a % depending on the length of time the asset has been held. Taper relief does not apply to corporation tax on chargeable gains.

Generally taper relief will be more beneficial where the base cost is low.

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CAPITAL GAINS TAX INDEXATION ALLOWANCE

Examples

- (1) Mr Happy bought an asset in November 1985 for £30,000. He sold the asset on 28 May 2001 for the sum of £95,000. The capital gain is calculated as follows: -

Sale Proceeds	95,000
Cost of Asset	<u>30,000</u>
Unindexed Gain	65,000

$$\begin{array}{r} \text{Indexation Factor: -} \\ 162.6 - 95.92 \\ \hline 95.92 \end{array} = 0.695$$

Indexation Allowance: -

0.695 x 30,000	<u>20,850</u>
Chargeable gain (subject to taper relief)	<u>44,150</u>

- (2) As above except that sale proceeds are £40,000.

Sale Proceeds	40,000
Cost of Asset	<u>30,000</u>
Unindexed Gain	10,000
Indexation restricted to	<u>10,000</u>
Thus no gain/loss on disposal	_____ -

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