Capital Gains Tax – Back to Basics.

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This article explores some of the more common Capital Gains Tax (CGT) issues and provides some advice to students preparing for exams on basic approaches to be used.

Sometimes a CGT exam question can appear daunting to those studying it, particularly if there are a number of different aspects in a particular scenario. There is a way to avoid being daunted and that is in every capital gains tax question to go back to basics and ask yourself 4 key questions i.e.

a. What is being disposed of and for how much? ***(PROCEEDS)***
b. What did the asset originally cost? ***(COST)***
c. What is the gain (or loss)? ***(GAIN)***
d. What is the tax? ***(TAX)***

There is a 5th question which may be asked depending on the question – what, if any reliefs are available which can be used to reduce the gain. The gain before applying any relief is a ***chargeable gain,*** the gain after applying any relief is known as the ***taxable gain*** – i.e., the figure to be actually taxed.

Admittedly, there can be many bells and whistles in any scenario, but if you keep the above questions clear in your mind for every disposal you won't go too far wrong.

Table 1

Example:

Taking the 4 questions above and putting them into a typical CGT calculation you get the following calculation for an asset that was sold for €10,000 and bought for €3,000 a couple of years ago.

1. Proceeds	10,000
2. Cost	(3,000)
3. Chargeable Gain	7,000
4. Less personal exemption	(1,270)*
5. Taxable Gain	5,730
6. Tax at 33%	1,891

*Personal exemption (p/e) is an example of a relief and it applies in virtually every CGT calculation, but remember that if your gain is less than p/e, the p/e only works to wipe out the gain. Unused p/e cannot be carried forward.

Virtually every CGT calculation you will ever do will involve the steps in the above table. Some will involve additional steps but it's very important, particularly in an exam to keep the structure of the above table clearly in your mind. So, keep the basics clearly in your head, and then add any bells and whistles.

Proceeds

Many CGT disposals involve the sale of an asset for a consideration. Some disposals, however, may not involve a sale, (for example a gift) and in this case ***Market Value*** will be used instead of sales proceeds. Likewise, when you dispose of an asset to a "connected person" Market Value will be used in place of Sales Proceeds.

Also remember, you may deduct any incidental costs (e.g., legal fees) associated with the sale to reduce the amount of consideration.

Cost

This relates to the original cost of the asset when it was acquired (or if acquired before 6th April 1974, the market value of the asset on that date). Remember, again, that you can add incidental disposal costs onto the original costs.

There are two key elements to bear in mind when considering the original cost of an asset:

1. **"Indexation".**

This means that the cost of any asset acquired in 2002, or before 2002, can be inflated to reduce the gain. The amount of indexation depends on the year it was acquired. A table will be provided in your exams showing different index factors for different years. Once you identify the correct index, simply multiply your cost by your factor to give you the "indexed" cost which you use to calculate the gain.

For example, if you bought an asset for €100,000 and the index factor was 1.45, then the cost to be used in your calculation is not €100,000 but €145,000. (Be sure, in an exam, to show your index factor clearly).

Table 2

Example:
If you sold an asset in 2020 for €200,000 & incurred incidental costs of €3,000, and had acquired it in May 1997 for 100,000 with incidental costs of 2,500 the following is the calculation:

Proceeds	200,000	
Less incidental costs	(3,000)	
Net Proceeds		197,000
Cost	100,000	
Plus incidental costs	2,500	
Total cost of asset	(102,500)	
Index Factor (1997/98)	1.232	
Indexed Cost		(126,280)
Chargeable Gain		70,720
Less personal exemption		(1,270)
Taxable Gain		69,450
Tax @ 33%		22,919

You will note that all of the 4 steps in Table 1 above are included in this calculation. Some additional features have been introduced, namely (a) the inclusion of incidental costs, and (b) the introduction of indexation. Remember that if an asset was acquired in 2003 or later, there is no indexation.

Losses

When disposing of assets during a year, it is permissible to offset a gain on asset against a loss on another.

Table 3

Example:		
Liam sold a plot of land in 2020 for €20,000. He had bought the land in 2015 for €12,500. He also sold a painting in 2020 for €30,000 which he bought in 2010 for €40,000. His CGT calculation is as follows:		
Land		
Proceeds	20,000	
Cost	(12,500)	
Chargeable Gain		7,500
Painting		
Proceeds	30,000	
Cost	(40,000)	
Loss		(10,000)
Net Loss		(2,500)*
*Note – this loss can be carried forward to be offset against gains in future years		

It is very important to remember that there are circumstances where the ability to offset a loss is curtailed. A key example is where the disposal is between "connected parties" – often family members.

Table 4

Example:			
Mary disposes of two assets during 2020, one being shares she bought in 2015 for 20,000, the other being a necklace she bought for 10,000 in 2013. She got 25,000 for the shares on the open market, and 5,000 for the necklace she sold to her sister.			
Shares			
Proceeds	20,000		
Cost	(10,000)		
Chargeable Gain		10,000	
Necklace			
Proceeds	5,000		
Cost	(10,000)		
Loss		(5,000)*	
Chargeable gain			10,000
Less personal exemption		(1,270)	
Taxable gain		8,730	
Tax ´33%		2,881	
*Note: She is not entitled to offset the necklace loss against the shares gain as the necklace is disposed of to a "connected person" i.e., her sister. The only way she can utilise this loss is against a gain she makes on a disposal to the same connected person, either now, or in the future.			

Limitations of Indexation

1. Indexation cannot increase a loss. If it does it is the ***actual loss*** that is used.
2. Indexation cannot increase a gain. If it does it is the ***actual gain*** that is used.
3. Indexation cannot turn an actual gain into a loss. If it does the ***NGNL*** (No gain, no loss) rule applies.

4. Indexation cannot turn an actual loss into a gain. If it does the ***NGNL*** (No gain, no loss) rule applies.

2. "Enhancement Expenditure"

This is where you spend money adding to or improving the asset – for example you may add a conservatory to a house. The cost of this is added to the original cost (and indexed as well if pre-2003).

Cost where an asset has been received as a gift or inheritance.

In some cases, assets are disposed of where they had not been purchased. The procedure here is that the Market Value on the day the asset was received is deemed to be the original cost of the asset.

Table 5

Example:

If John receives a gift of a house from his father in May 1998 when it was worth 50,000 and sells it in 2020 for 200,000, the following is the calculation.

Proceeds		200,000
Cost (Market Value)	50,000	
Index Factor (1998/99)	1.212	
Indexed Cost		(60,600)
Chargeable Gain		138,130
Less personal exemption		(1,270)
Taxable Gain		136,860
Tax @ 33%		45,164

Again, it is worth noting that all the steps in Table 1 apply here. (I sometimes say to students that before answering a CGT question in an exam it is worthwhile writing down the headings in Table 1 and use it as a guide).

Transfer of assets between spouses

There is no CGT on transfer of assets between spouses. When a spouse disposes of an asset which they had received from the other spouse the cost to be used is the original cost to the first spouse.

Where a couple are jointly assessed one spouse may use the other spouses losses for offset against their gains.

Table 6

Example: John's wife Lelia disposed of a painting in 2020 for €50,000. She had originally been given the painting as a gift by John in 2015 when it was valued at €25,000. He in turn had inherited it from his mother in May 1996 when it was worth €10,000.

Proceeds		50,000
Cost		
Inheritance (96/97)	10,000*	
Index	1.251	
Indexed cost		(12,510)
Chargeable Gain		37,490
Less personal exemption		(1,270
Taxable Gain		36,220
Tax @ 33%		11,953

*Note – the base cost for Lelia is the market value that John originally acquired it at i.e., €10,000. A common mistake students make is to use the value on the day her husband gave it to her as the base cost. For CGT purposes remember to ignore any transfers between spouses when determining the base cost.

Part Disposal

Sometimes part of an asset is disposed of – for example a parcel of land from a farm. The sales proceeds are easy to determine, but what can be a bit more complicated is deciding how much of the original cost is to be used for purposes of capital gains tax.

A formula is used to determine this:

Original Cost of Asset x ***A/A+B***

Where

A = sale proceeds of part disposal

B= value of the remaining asset after the part disposal.

Table 7

Example:
Sinead bought a farm in 2009 for €200,000. She sold an acre in 2020 for 20,000. The value of the farm today after disposal is 250,000.

Proceeds			20,000
Cost	200,000 x 20,000/(20,000+250,000)		
	=		(14,815)
Chargeable Gain			5,185
Less personal exemption		(1,270)	
Taxable Gain		3,915	
Tax @ 33%		1,292	

Shares

Share portfolios are often assembled over a number of years. So, when it comes to dispose of them two things are important. First each "bundle" of shares is treated as an asset in its own right – the total portfolio is not one asset. Second, when disposing of some shares in a portfolio the FIFO (first in first out) rule applies – you are selling the shares you acquired earliest first.

Table 8

Example:

Trish sold 3,000 shares in Small Bank plc in 2020 for €0.50 each. She owned a portfolio of 5,000 shares in Small Bank which she had acquired as follows:

January 2005	1,000 shares at €5 each
January 2006	1,000 shares at €4 each
January 2007	1,000 shares at €3 each
January 2008	1,000 shares at €2 each
January 2009	1,000 shares at €1 each

As she is now selling 3,000 shares it is very important to know which 3,000 she is selling. The answer lies in the FIFO rule – she sells the 3,000 shares she acquired first.

Proceeds - 3,000 shares @ 0.50		=	1,500
Cost			
1,000 shares @ €5 each (from 2005)	5,000		
1,000 shares @ €4 each (from 2006)	4,000		
1,000 shares @ €3 each (from 2007)	3,000		
TOTAL Cost			(12,000)
Loss			(10,500)

Wasting Chattels

These are assets with a useful life of less than 50 years (for example a car). Disposals are exempt from CGT.

Proceeds less than €1800

Disposal of assets where the proceeds are less than €1800 are exempt from CGT.

Residence

Remember that where the person disposing of the asset is resident, ordinarily resident and domiciled in Ireland they are liable for CGT on disposal of assets anywhere in the world, irrespective of whether they repatriated the proceeds to Ireland or not.

Reliefs

Reliefs serve to reduce the gain (n.b. not the tax). The personal exemption (€1,270) is a relief (and always remember to deduct it from the gain, and not from the tax owing)

There are two key reliefs you need to bear in mind:

1. **Principal Private Residence Relief**
2. **Entrepreneur Relief**

Principal Private Residence (PPR) Relief

This relief serves to reduce the gain on your Principal Private Residence, possibly down to zero. If you occupied your residence all the time you owned it, you get 100% relief, and the gain (and thus tax) is reduced to zero. If you occupied it for 50% of the period of ownership then your gain is reduced by 50%, and so on.

Table 9

Example:

Sarah bought a house for €50,000 on January 1st 2003, and lived in it up to December 31st 2020 when she sold it for €200,000.

John bought a house for €50,000 on January 1st 2003 and moved into it on January 1st 2010. He sold it for €200,000 on 31st December 2020.

	Sarah	John
Proceeds	200,000	200,000
Cost	(50,000)	(50,000)
Chargeable Gain	150,000	150,000
PPR Relief	(150,000)*	(91,250)*
	0	58,500
Personal Exemption	n/a	(1,270)
Taxable Gain	0	57,230
Tax @ 33%	0	18.886

*PPR Relief

	Sarah	John
Period of ownership	18 yrs	18 yrs
Period of occupation	18 yrs	11 yrs
Occupation % of ownership	100%	61%
Relief	100% of gain	61% of gain
*Relief	150,000	91,500

"Deemed" Occupation

There are certain circumstances where people can be deemed for CGT purposes to be occupying their home, even if they aren't there.

These are:

1. Any period spent abroad working.
2. Any period of up to 4 years working elsewhere in Ireland.
3. The last year of ownership regardless of location.

Entrepreneur Relief

A special CGT rate applies to qualifying entrepreneurs when they sell businesses they started. The scheme allows for the first €1m to be taxed at 10%, and the balance at the normal rate of 33%. The €1m is a lifetime limit.

Table 10

Example:		
Joe starts a business from scratch and after 4 years sells it for €4 million.		
Proceeds		4,000,000
Cost		0
Chargeable gain		4,000,000
Personal exemption		(1,270)
Taxable Gain		3,998,730
Tax		
1,000,000 @ 10%	= 100,000	
2,998,730 @ 33%	= 989,581	
TOTAL TAX	= 1,089,581	

Administration

Payment

Payment of any CGT due depends on when the disposal took place.

For disposals which occur between January 1st and November 31st in any year, the CGT must be paid by 15th December in the same year.

For disposals which occur in December in any year, the CGT must be paid by 31st January in the following year.

Returns

All CGT returns must be made by 31st October in the year following the disposals.

Late filing of returns

Where a return is filed up to 2 months late a levy of 5% of the tax due is applied – up to a max of €12,695

Where a return is filed more than 2 months late a levy of 10% of the tax due is applied – up to a max of €63,485