

A fine line

Robert Coram James looks at the capital gains tax rules around fine art and antiques, and how tax and estate planners can help their clients make the most of the potential exemptions available

On 20 July 2010, the chancellor and exchequer secretary launched the grandly named Office of Tax Simplification (OTS) to provide the government with independent advice on simplifying the UK tax system. On 10 March 2011, the OTS published its eagerly anticipated report, in which 155 proposals were made, among them the recommendation to double the current capital gains tax (CGT) allowance threshold for art, antiques and other chattels from £6,000 to £12,000.

Although these proposals came too late to be implemented in this year's budget, the recommendations may still be considered for 2012. If so, it would be the first time the allowance threshold has been raised for art and antiques for 22 years. There is no apparent reason as to why art and antiques have been singled out for favourable treatment, although it does bring the figure in line with inflation, and could be seen as a reward for investment which encourages trade.

VALUATIONS

The OTS's proposals are of particular interest in relation to art and antiques valuations. Valuations are often requested calculating the gain (or loss) in the value of art, antiques and other personal possessions for the assessment of CGT. The gain is treated as the difference between the item's original cost, donation or inheritance value and its eventual sale price or value when gifted, less the costs associated with restoration and sale.

Under the current system, if the eventual sale price is less than £6,000, or if disposal is by way of gift and the value is less than £6,000, then no CGT is payable. If disposed of for more than £6,000, the chargeable gain is limited to the lower figure of either:

- a) the actual gain; or
- b) 5/3 of the difference between the gross sale price or gift value on the one hand, and £6,000 on the other.

DETERMINING VALUE

The legislation dealing with CGT is found in the Taxation of Chargeable Gains Act 1992 (TCGA 1992).

In section 17 of the TCGA 1992, it is set out that valuations for disposals and acquisitions should be taken at market levels – that is, “the price which the property might reasonably be expected to fetch if sold on the open market at that time” (as defined in section 160 of the Inheritance Tax Act 1984). For tax purposes, nothing else will be acceptable.

An experienced valuer will only arrive at market values after making a detailed examination of the items in question and carrying out the necessary research. Insurance valuations, for example, should not be used as a means to calculate the market

value, as these figures reflect the retail replacement price, and can often be two or three times the market value.

CGT, which was introduced in 1965 under Harold Wilson's first Labour government, was designed so that the tax charge was effectively limited to the gain accruing from 6 April 1965 to the date of disposal. In 1988, new rules were introduced to move the base date forward to 31 March 1982, which still remains in place. From a valuer's perspective, valuing chattels acquired prior to the base date and applying retrospective values presents certain obvious difficulties, and is a challenge for even the most experienced

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valuer. Without recent comparables, often the only resources available to the valuer are in the form of archived material, such as sale catalogues, published indexes and online price databases. Clearly, valuing an asset acquired after 31 March 1982, is more straightforward, as values can be based on recent comparables.

In some cases, clients are surprised by the result of a valuation. For instance, some items may have fallen out of fashion and dropped significantly in value. ‘Brown’ furniture, such as mahogany bureaux or walnut chests of drawers, particularly larger items, have dropped in value a great deal over the last 15-20 years, and may be worth far less than anticipated.

A valuer should also be aware of the turn of the market, and be capable of judging the physical condition of the object. If a valuable item has been badly restored or kept in inappropriate conditions, then the value will suffer.

EXEMPTIONS

There are a number of exemptions to the current law around the CGT payable on art, antiques and other chattels.

SETS OF CHATTELS

In some cases, exceptions may not be beneficial to clients – for instance, in relation to chattels which form a set.

The TCGA 1992 provides that, if two or more assets form part of a set, they shall be treated as a single transaction. A set is generally considered as a number of chattels that are similar and complementary to each other, and worth more together than separately. Examples of sets are chessmen, books by the same



author or on the same subject, and matching ornaments, such as vases or statuettes. When disposing of a number of chattels that form a set, the £6,000 limit that normally applies to a single chattel, applies to the set.

WASTING ASSETS

However, in other cases, exceptions represent attractive potential CGT concessions, which may be well worth considering.

For instance, any chattels that are defined as wasting assets will not give rise to a chargeable gain, nor an allowable loss. Section 44 of the TCGA 1992 provides that a wasting asset is one that has a predictable life not exceeding 50 years. For these purposes, machinery is always regarded as a wasting asset, to include cars, watches, clocks, yachts and motorbikes.

Wines and spirits will often fall within this tax-free bracket, providing they are stored in a bonded warehouse, as the majority is perishable and declines in quality after 25 years. However, for exceptional examples, HM Revenue and Customs (HMRC) may decide that there will be an improvement in quality and value after 50 years, in which case, the exemption will not apply. Consideration should also be given as to whether the items make up a set. To decide this, HMRC will look at whether the sale is to the same purchaser, whether it is one sale or a series of transactions, whether the bottles are similar, and whether the bottles would be worth more when sold together or separately.

ITEMS OF NATIONAL IMPORTANCE

Another potential advantage lies in circumstances where works of art are recognised as being of national importance, as there will be an exemption on sale of these items from CGT. Under the National Heritage scheme known as 'conditional exemption', owners of artistically or historically significant works of art are eligible for a deferral of CGT and / or inheritance tax, which can be claimed within two years of any other taxable transfer of value. In return, the

owner must agree to preserve and maintain the item, keep it in the UK, and allow public access. However, as the name implies, the exemption is conditional. If the owner fails to fulfil their side of the bargain, the exemption is withdrawn, and tax is payable.

Changes to the scheme under the Finance Act 1998 not only made it much harder for objects to qualify for the exemption, but also represented a major tightening of the rules on public access. HMRC may demand that all chattels, whether historically important in their own right or associated with a historical building, be available to the public for between 25 and 156 days a year, with admission by prior appointment at all other times. Owners are also expected to publicise the terms of access, and ensure reasonable means of entry.

A wide range of items can qualify for conditional exemption, such as fine art, furniture and sculpture, and even cars and yachts, providing they are of artistic, historic or scientific interest in their own right. A valuation report is essential to identify potentially exempt items, and the valuer can help prepare the documentation for presentation to the Museum, Libraries and Archives Council, which runs the system.

CONCLUSION

As this article demonstrates, the rules relating to CGT on the disposal of chattels are complicated, and tax and valuation advice should be taken before planning is put in place, in order to mitigate the tax payable. Using the services of a professional valuer can also be of great help, whether for chattels valuations or for advice on the various National Heritage schemes. ■

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