R02 Investment Principles and Risk

2024-2025 Exam Year

# Mid-Year Study Guide update

V1.0

## R02 Investment Principles and Risk

## 2024-2025 Study Guide – Mid-Year content update as of 1 March 2025

Please note the following updates to your copy of the R02 Study Guide (amendments in **bold**):

**CGT rates / SDLT rates**

As announced in the October 2024 Budget

- The Non and Basic rates of CGT have been increased from 10% to 18%.
- The Higher and Additional rates of CGT have been increased from 20% to 24%.
- Changes to the Stamp Duty Land Tax rates

Also included are various miscellaneous updates as summarised below.

### Chapter 1.4.4, page 67

Also since April 2016, any second home or buy-to-let residential property purchased for £40,000 or more is liable to pay an extra **5%** SDLT on top of the usual rates (inc. the first bands, which are normally SDLT free).

### Chapter 1 Knowledge check, page 91

| | |
|---|---|
| 15 | A limited company has purchased a residential property in Kensington for £1,650,000. What would the Stamp Duty Land Tax be on this transaction?<br>A. £65,000.<br>B. £72,000.<br>C. £111,750.<br>***D. £280,500.*** |
| | **£1,650,000 x 17% = £280,500** |

### Chapter 6.3.2d, page 212

| CAPITAL GAINS TAX | |
|---|---|
| EXEMPTIONS | 2024/25 |
| Individuals, estates etc. | £3,000 |
| Trusts generally | £1,500 |
| Chattels proceeds (restricted to five thirds of proceeds exceeding limit) | £6,000 |
| TAX RATES, Individuals: | |
| Up to basic rate limit | **18%** |
| Above basic rate limit | **24%** |

NOTE:

**There used to be an 8% CGT surcharge levied where the gains come from residential property (second homes and buy-to-let) for non and basic rate taxpayers, and a 24% charge for higher and additional rate taxpayers.**

**The rates were 'equalised' in the October 2024 budget by increasing the standard CGT rates to match the previous higher rates that previously only applied to second residential properties**. ~~his will give them an 18% CGT rate.~~

~~A charge of 24% is levied on residential properties (second home and buy-to-let) for higher rate and additional rate tax payers (effectively a 4% surcharge). The reason that HMRC give for introducing this lower surcharge for higher and additional rate taxpayers in 2024 was:~~

~~*"Cutting the 28% rate of CGT to 24% is expected to incentivise earlier disposals of second homes, buy-to-let property and other residential property where accrued gains do not fully benefit from PRR. This will generate more transactions in the property market, benefitting those looking to move home or get onto the property ladder".*~~

## Chapter 6.3.2d, page 213

Any taxable gain that falls in the basic rate tax band will be taxed at **18%**. If it falls above this, it will be taxed at **24%.**

In our graph above:

- Gain 1 will all be taxed at **18%.**
- Gain 2 would be part taxed at **18%**, part at **24%.**
- Gain 3 would be all taxed at **24%.**

So, an individual with a small amount of income and a large gain could pay CGT at both rates.

**Example 6.4**

Jake invested £10,000 into a unit trust 10 years ago and has just realised a gain of £60,000.

He has no losses and has already used his annual CGT exemption. His income after applying the personal allowance is £30,000. The threshold for basic rate tax is £37,700.

This means that Jake is in the same position as 'Gain 2' in the graphic above.

- £7,700 of Jake's gain (£37,700 - £30,000) 'uses up' the remainder of his basic rate tax band and is taxed, for CGT, at **18% = £1,386**.
- His remaining gain of £52,300 (£60,000 - £7,700) is taxed at **24% = £12,552.**
- His total CGT liability would therefore be **£13,938.**

**Chapter 6.4.2, page 223**

<table>
<tr><th></th><th>OEIC</th><th>UNIT TRUST</th></tr>
<tr><td rowspan="1">Structure</td><td>Limited company.<br>Issues shares.<br>Open-ended.</td><td>Trust structure.<br>Issues units.<br>Open-ended.</td></tr>
<tr><td rowspan="2">Contributions</td><td colspan="2">Minimums and maximums depend on provider/ACD rules.<br>Accept both single and regular contributions.</td></tr>
<tr><td>Large contributions can trigger an extra discretionary charge: the dilution levy.</td><td></td></tr>
<tr><td>Internal structure</td><td>Run by an Authorised Corporate Director (ACD).<br>Depositary safeguards shareholder interests.</td><td>Run by a unit trust manager.<br>Trustee safeguards unit holder interests.</td></tr>
<tr><td>Investor liabilities on income</td><td colspan="2">Equity based:<br><br>Paid to the investor without any tax deducted.<br>£1,000 dividend allowance can be used.<br>Dividend income above £500 is taxed as:<br>○ 8.75% liability for basic rate taxpayers.<br>○ 33.75% for HRTP.<br>○ 39.35% for ARTP.<br>Non-equity based:<br><br>Paid gross.<br>Personal Savings Allowance (PSA) of £1,000 for basic rate and £500 for higher rate taxpayer applies.<br>Above this:<br>○ 20% payable for basic rate taxpayer.<br>○ 40% payable for higher rate taxpayer.<br>○ 45% payable by additional rate taxpayer.</td></tr>
<tr><td>Investor liabilities on gains</td><td colspan="2">CGT due on any gains more than current annual exemption of £3,000.<br>18% or 24% depending on other income levels.<br>Losses can be offset against gains.</td></tr>
<tr><td rowspan="2">Investor protection</td><td colspan="2">FSCS protection up to 100% of investment amount, capped at £85,000.</td></tr>
<tr><td>Protected by company law, depositary and the regulator.</td><td>Protected by trust law, trustees and the regulator.</td></tr>
</table>

**Chapter 6.6, page 226**

**Example 6.9**

Jeff and Lisa both have offshore funds and are higher rate taxpayers.

Jeff has a reporting and Lisa a non-reporting fund.

They have both realised gains of £10,000. Both have already utilised their CGT exemption.

- Jeff will pay CGT at **24%** on his £10,000 gain = £2,400.
- Lisa will pay 40% income tax on her £10,000 gain = £4,000.

Lisa will therefore pay £2,000 more in taxation on her gain than Jeff.

**Chapter 6.6, page 227**

| Onshore Funds | Offshore Funds |
|---|---|
| Made up of Unit trusts or OEICS<br>(can also include investment trust and life assurance-based funds but let's keep it simple!).<br>Equity or non-equity based.<br>Investors who receive equity-based dividends can use the £500 dividend allowance, income above that is taxable.<br>There is a further 8.75%, 33.75 or 39.35% investor liability on income distributions.<br>Investors who have non-equity funds can use the £1,000/£500 Personal Savings Allowance (PSA).<br>Income distributions paid gross.<br>Income above PSA is taxable:<br>○ SRTP or non-taxpayer investor: nothing to pay,<br>○ BRT have 20% to pay on excess,<br>○ HRT pays 40% on excess,<br>○ ART pays 45% on excess<br>○ through Self-assessment.<br>CGT treatment the same:<br>○ take-off annual exemption if not used.<br>○ then **18 / 24%** depending on other net taxable income in that same year. | Usually have the structure of unit trusts or OEICS with two categories of fund:<br>Reporting.<br>Must report income to the 'HMRC and other Participants' to be classed as a reporting fund (not the same as distributing).<br>Income taxed according to asset mix.<br>Equity or non-equity income taxation applied.<br>No tax taken at source.<br>Investor pays full liability if extra to pay.<br>Nothing to reclaim as nothing paid.<br>Gains taxed in line with standard CGT rules:<br>○ take off annual exemption if not used.<br>○ then **18 / 24%** depending on other net taxable income in that same year.<br>Non-Reporting.<br>Roll up funds/no income paid.<br>Gains potential but taxed under income tax rules!<br>Full income tax liability down to the investor.<br>So, could be 20%, 40% or 45%. |

### Chapter 6.8.6, page 270

| | Qualifying Policy | Non-qualifying policy |
|---|---|---|
| **Income Tax** | If a qualifying policy was bought that retained its qualifying status, then maturity or original policyholder's death are not chargeable events. | Maturity is a chargeable event, but the gain is based on the maturity value or surrender value immediately before death minus total premiums paid by the buyer and seller. |
| **CGT** | The buyer has a potential CGT (**18%** or **24%)** on final sale, or original policyholder's death, as they were not the original policy owners.<br>The buyer can use any unused CGT allowance to offset any gains.<br>The same gain will not suffer both income tax and CGT. | |

### Chapter 6.11.1b, page 280

**Example 6.32**

Christopher, a higher rate income taxpayer, has just sold some BP shares for a profit of £200,000.

Everything was good until he saw his CGT bill of £40,000.

If he re-invested his profit into an EIS, then he could claim for CGT deferral relief.

The tax due would then only be payable when he ultimately disposes of the EIS shares, more than likely in many years to come.

He may save on his CGT rate at that point, as he may be a basic rate taxpayer rather than higher or additional rate, and therefore pay some at **18%** rather than all at **24%** CGT.

### Chapter 6 Knowledge check, page 323

| | |
|---|---|
| 7 | Graham and Thomas are both higher-rate taxpayers, who have fully utilised their CGT exemption in the current tax year. They have invested in offshore funds. Graham has a reporting fund and Thomas a non-reporting fund. What will their respective tax liabilities be on an identical gain of £10,000?<br>A. Graham will pay £1,200 more than Thomas.<br>B. Graham will pay **£1,600** more than Thomas.<br>***C. Thomas will pay £1,600 more than Graham.***<br>D. Thomas will pay £1,200 more than Graham. |
| | **Reporting funds pay CGT on gains but non-reporting, whilst calculated on CGT principles, pay income tax.**<br>**Therefore, Graham will pay £10,000 x 24% = £2,400 and Thomas will pay £10,000 x 40% = £4,000.**<br>**Thomas pays £1,600 more tax.** |

### Chapter 6 Activity answers, page 329

**Activity 6.2**

Capital Gains Tax for investors in unit trusts.

Calculate the CGT payable for Astrid from the information below:

Astrid earns £60,000 per year and is a higher rate taxpayer.
On 7th May 1995, she invested £20,000 in the XY unit trust and has just cashed this in for £35,987.

| CGT | |
|---|---|
| Disposal proceeds | 35,987 |
| Less acquisition cost | (20,000) |
| Gain on XY unit trust | 15,987 |
| Less annual exemption | (3,000) |
| Taxable gain | 12,987 |

Tax due £12,987 x **24% = £3,116.88**

### Chapter 8.7.1, page 380

Sometimes it is better to use a wrapper that produces income tax savings rather than one that saves on CGT.

This is because few people actually make gains above the CGT threshold, even at its lower value of £3,000 for the 2024-25 tax year. Even if they do, the gain is taxed at a maximum of **24%**.

Rolled-up income can be taxed at higher rates such as 40% and 45%, and more people are likely to suffer higher rate income tax.

An income tax-efficient wrapper can save some income tax. It is likely to benefit more people than a CGT-efficient wrapper.

### Specimen paper, question 5

5 Harry, who owns his own home, is buying a residential property in Bradford for £350,000 which he is renting out to provide additional income, and Gerald is remortgaging his £300,000 property. How much more will Harry pay in Stamp Duty Land Tax than Gerald?

a) £2,500
b) £5,000
c) £12,500
d) **£22,500**

| | | |
|---|---|---|
| 5 | D | **Gerald is re-mortgaging. No SD is paid as no land transfer has taken place.**<br>**Harry will pay SDLT at the standard rates, but will also have an additional 5% surcharge as it is a second residential property:**<br>**First £250,000 x 5% = £12,500**<br>**Next £100,000 x 10% = £10,000**<br>**The total SDLT will be £22,500** |

**Specimen paper, question 41**

41 Lisa, an additional rate taxpayer and her partner Peter, a basic rate taxpayer, have both made a gain of £5,000 on the sale of some shares. How much more CGT will Lisa pay than Peter if both have already used their annual CGT exemption?

a) None
b) **£300**
c) **£900**
d) **£1,200**

| | | |
|---|---|---|
| 41 | B | **Lisa will pay CGT at 24% whereas Peter will have an 18% liability.**<br>**£5,000 gain x 24% = £1,200. £5,000 gain x 18% = £900. £1,200 - £900 = £300**<br>**Or £5,000 x 6% difference = £300.** |

**Specimen paper, question 71**

| | | |
|---|---|---|
| **71** | **D** | Option A is incorrect: there is no minimum tenant period. Option B is too simplistic: for net yield calculations; costs should be taken into account, such as any management fees and house purchase costs such as solicitor fees and SD. Property is exposed to liquidity risk. A Stamp Duty surcharge of **5%** will be added to each rate (even the 0% rate). |

If you have any queries regarding these updates or any other regulation changes, or if you require any more information about BTS and the services we provide, please contact us at:

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