QUILTER CHEVIOT

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Capital gains tax and MPS

The annual exempt amount (AEA) for capital gains tax has been halved for the 2024/25 tax year, completing a two-staged reduction that significantly diminishes its benefits. Jeremy Hunt has moved to reduce a number of exemptions during his stint as UK chancellor as he seeks to shore up public finances and restore credibility for prudent fiscal management after the fallout from his predecessor's "mini-Budget".

For the 2024/25 tax year the AEA for capital gains tax (CGT) has been set at **£3,000,** down from **£6,000** in 2023/24 and **£12,300** in 2022/23. For many investors this means that a larger portion of their returns from investments will be subject to this levy.

What does the change in the annual exempt amount mean for Managed Portfolio Services (MPS)?

Traditionally, MPS portfolios have been constructed by Investment Managers to provide clients with exposure to a range of asset classes, typically accessed through the selection of externally managed third-party funds. To implement any changes at the security level (for instance, to reflect a change in the Investment Manager's preferred exposures) requires an Investment Manager to adjust the blend of these external funds.

While CGT is not payable on investments held in tax-efficient wrappers such as pensions and ISAs, holdings in general investment accounts (GIAs) are potentially exposed to CGT, with the tax incurred on any profits crystallised above the client's AEA. As such, should an Investment Manager, for example, wish to increase the exposure to Information Technology companies within a client's North American equity exposure, they may be required to reduce (or sell in full) the holding of a fund with zero exposure to this sector, in favour of another that has positioned its fund to hold a number of these companies. If a client's MPS portfolio was held within a GIA, and their AEA had been exceeded for the year, this action would represent a chargeable event.

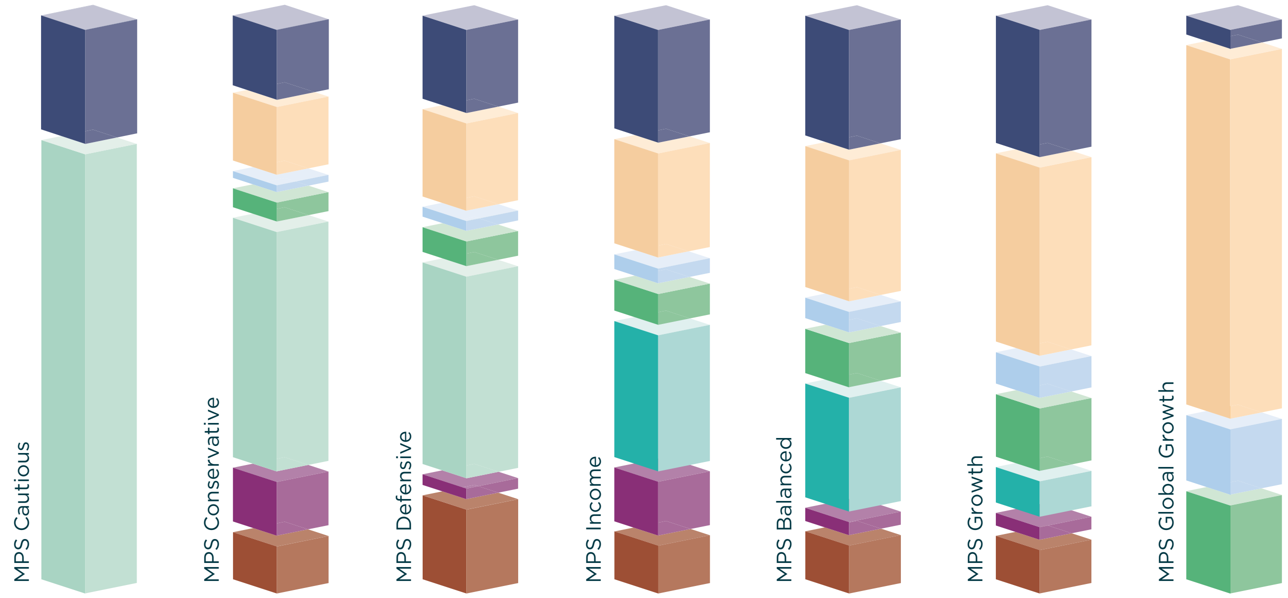
What about Quilter Cheviot's MPS?

Our approach to constructing clients' MPS portfolios is unique and is centred around the incorporation of the 'Building Blocks', a range of eight funds designed exclusively for use within Quilter Cheviot's MPS strategies. These funds are combined in different weights to create our MPS strategies, which provide a range of different investment objectives and risk profiles to financial advisers and their clients:

Approver: Quilter Cheviot Limited 12 March 2024

The 7 MPS Strategies

For Illustrative purposes only

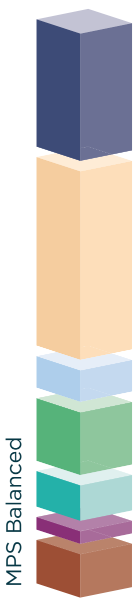


- UK Equity
- Conservative Fixed Interest
- European Equity
- Diversified Returns
- North American Equity
- Fixed Interest
- Asian & EM Equity
- Alternative Assets

Constructing our MPS strategies in this manner brings with it a number of benefits, including complete control over how a client's investment portfolio is composed.

By having responsibility as the MPS model manager (determining the blend of asset classes within the strategy by setting the chosen weight to each Building Block), as well as acting as the appointed fund manager to each Building Block (determining the composition of the underlying investments within each fund), our approach reduces the possibility of crystallisation events occurring at the security level. This is because changes to security selection exposures take place within the underlying Building Block structures, an environment not subject to CGT. Only asset allocation changes (e.g., reducing the European Building Block in favour of the UK Building Block) are deemed crystallisation events, thereby potentially realising a profit or loss for CGT purposes.

To revisit our example from earlier, a decision to increase exposure to Information Technology companies within the North American equity exposure would be implemented within Quilter Cheviot's MPS in a swift, granular fashion: one that avoids the need for time out of the market, a cumbersome 'rebalance' between different fund holdings or, crucially for this example, a requirement to crystallise profits at the portfolio level. The MPS managers would simply implement this investment decision within the North American Building Block, increasing exposure to the preferred companies within the sector. An example of the types of companies owned within the fund can be found below:



MI Quilter Cheviot North American Equity fund		
Top Holdings	**Fund weight %**	**Model weight %**
Microsoft Corp Com USD0.00000625	7.69	2.08
Amazon Com Inc Com USD0.01	4.83	1.30
Apple Inc Com USD0.00001	4.73	1.28
Alphabet Inc Capital Stock USD0.001 Cl A	3.07	0.83
Nvidia Corp Com USD0.001	3.04	0.82
Linde Plc Com EUR0.001	2.99	0.81
Thermo Fisher Scientific Inc Com USD1	2.98	0.81
Meta Platforms Inc Com USD0.000006 Cl 'A'	2.93	0.79
Visa Inc Com Stk USD0.0001 'A'	2.92	0.79
Advanced Micro Devices Inc Com Stk USD0.01	2.90	0.78
Canadian Pacific Kansas City Ltd	2.83	0.76
Merck & Co Inc Com USD0.50	2.76	0.74
United Rentals Inc Com Stk USD0.01	2.26	0.61
Netflix Inc Com USD0.001	2.11	0.57
Zoetis Inc Com USD0.01 Cl 'A'	2.02	0.55

As can be seen, this Building Blocks approach allows us to be more agile than traditional MPS solutions, with investment changes implemented without the need for wholesale strategy rebalancing.

What does this mean for clients?

Whilst our MPS is CGT agnostic (we do not consider tax implications in our investment decisions), since moving to the "Building Blocks" approach our portfolio turnover (a key consideration for CGT purposes) has been significantly reduced, with most of our active management decisions relating to specific stocks occurring within one of these Building Blocks. For a typical MPS Balanced client, portfolio turnover* was on average 6% during 2023, 14% during 2022, both down from an average of 26% during 2018-2020.

The continued reduction in portfolio turnover also occurred when the investment management team were particularly active in implementing changes to the underlying holdings within the strategy across both years: a function of the exceptionally fast-changing market backdrop.

> *"For a typical MPS Balanced client, portfolio turnover* was on average 6% during 2023 and 14% during 2022, both down from an average of 26% during 2018-2020."*
>
> *Based on analysis of MPS client accounts in Quilter Cheviot's custody

Is there a right answer?

The reduction in the AEA may encourage some investors to avoid realising gains, postponing crystallisation events in an attempt to reduce their tax bill. While this may appear preferable in the near term, over the longer term this strategy may be detrimental.

If, for instance, future CGT rates are higher, perhaps even equalised with those on income tax (current CGT for higher or additional rate taxpayers is 20% on shares/funds and 28% from residential property, while income tax is 40% for higher rate payers and 45% for additional rate payers) then it may be deemed preferable to avoid storing up all returns.

For CGT purposes, our offering sits somewhere in between a traditional MPS and a multi-asset strategy, whereby no returns are realised and there is a full gross roll-up in profits. As discussed, the approach also delivers a number of key implementation benefits, while also ensuring exceptional value-for-money for what constitutes a fully active investment solution.

For more on the subject, please visit our website to watch a short video from Technical Consultant, David Denton and Deputy Head of MPS, Antony Webb: **https://www.quiltercheviot.com/news-and-views/articles/capital-gains-tax-and-mps/**

Please contact your usual Quilter Cheviot representative should you wish to learn more, or alternatively visit **Managed Portfolio Service | Quilter Cheviot** for additional information.

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