

July 2020

Capital Gains Tax review – call for evidence

Introduction

The Chancellor has asked the Office of Tax Simplification (OTS) to conduct a review of Capital Gains Tax (CGT) and those aspects of corporation tax that relate to chargeable gains.¹ Thereafter these will be collectively referred to as ‘Capital Gains Tax’ or ‘CGT’ for simplicity of language.

The full scope of the review is set out in the scoping document.² After some background material, this call for evidence comes in two sections: the first seeks early high-level comments on the principles of CGT, while the second and primary section of the document invites more detailed comments on the technical detail and practical operation of CGT.

The earlier deadline for comments on the principles of CGT, will help shape the balance of the work and could put us in a position to provide an interim update on those bigger picture issues.

Both sections of this call for evidence seek written views from anyone interested in simplifying CGT, including individuals, business owners, professional advisors, representative bodies, and academia. Alongside this the OTS will also be meeting as many interested parties as it can, online, to hear views directly during the full consultation period.

The OTS has also published an online survey which seeks to gather data from individuals and owner-managed businesses about their knowledge and experience of CGT.

How to respond

Please submit your response on the principles of capital gains tax by 10 August 2020 and on the main section of this call for evidence by 12 October 2020. All responses should be sent to ots@ots.gov.uk.

When responding to either section of the call for evidence, it would be useful if you could provide a sense of scale or the level of impact of a particular issue, the potential impact on tax revenues, and any resulting taxpayer costs. There is no requirement to respond to all the questions or both sections of this call for evidence; responses focusing on particular areas or themes are just as welcome. Further guidance on what is required can be found in the specific sections.

A list of the professional advisers or representative bodies responding to this call for evidence will be included as an annex in the final report. Individuals who respond will not be named. No comments will be attributed to specific respondents unless the OTS has received permission to do so.

The OTS is interested in meeting with a wide range of stakeholders to discuss this review; please contact the OTS at ots@ots.gov.uk by 4 September 2020 if you would like to arrange such a meeting.

¹ <https://www.gov.uk/government/publications/chancellor-requests-ots-review-of-capital-gains-tax>

² <https://www.gov.uk/government/publications/ots-capital-gains-tax-review-scoping-document>

CGT context

Capital Gains Tax (CGT) was introduced from April 1965 as a charge on the disposal of capital assets. At the time the then Chancellor James Callaghan said:

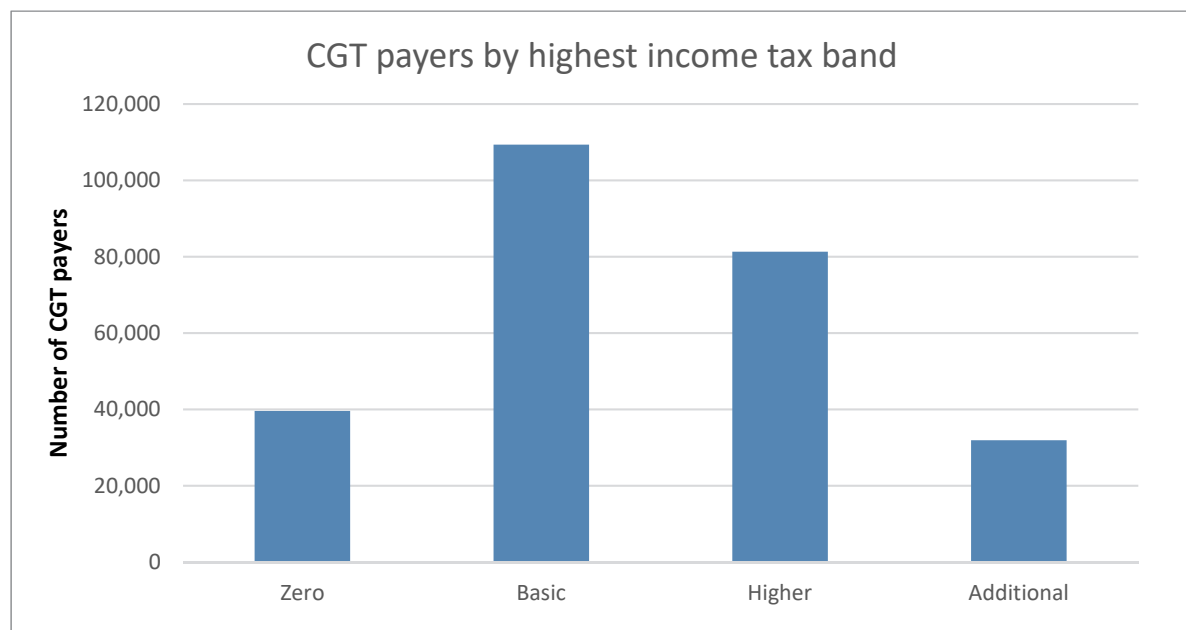
“... capital gains confer much the same kind of benefit on the recipient as taxed earnings... yet earnings pay tax in full while capital gains go free. This is unfair to the wage and salary earner... Moreover... the present immunity from tax of capital gains has given a powerful incentive to the skilful manipulator... to... turn what is really taxable income into tax-free capital gains.”

Although the nature of the tax has remained essentially unchanged since then, the rates and thresholds, its relationship with income tax and its supporting reliefs have changed significantly over that time.

CGT is a modest source of revenue for the Exchequer – sitting well behind income tax, National Insurance Contributions, VAT and corporation tax but ahead of Inheritance Tax. In 2017-18, chargeable gains subject to CGT after losses but before the annual exempt amount were £57.9 billion, an increase of 13%. CGT liabilities were £8.8 billion, up 14% on the previous year.³ This gives an average tax rate of 15%, reflecting impact of the annual exempt amount and the varied rates of tax.

The number of CGT taxpayers increased by 3% to 281,000 in 2017-18, continuing the long-term trend. Most, but not all, CGT is paid by a relatively small number of taxpayers, and on relatively large gains:

- Most of those with gains are taken out of tax entirely by the tax-free allowance (or Annual Exempt Amount)
- In 2017-18, 62% of CGT came from those who made gains of £1 million or more, which is generally around 3% of CGT taxpayers each year
- Those who pay CGT are twice as likely to pay higher rate income tax as taxpayers generally
- Over 70% of all those who pay CGT did so only once in the 11 years to 2017-18
- Over half of those who pay CGT either pay no income tax or only pay at the basic rates



Source: HMRC Outturn data 2017/18⁴

³ HMRC CGT statistics 2017/18

⁴ Data looks at the highest rate of income tax paid by income taxpayers above the personal allowance.

Section 1: Principles of CGT

Almost 10 years ago the Mirrlees review raised some fundamental questions about the nature of CGT. The review questioned whether government should continue with different rates of tax for different types of income, including income derived through capital gains (after allowing for a given rate of return).⁵ It also considered whether there should be different treatment for capital gains realised in life and for those gains realised on death.

With several changes to CGT over the last 10 years, including the recent changes to Entrepreneurs' Relief (now known as Business Asset Disposal Relief), it may be helpful to consider the tax again in the current climate.

The OTS would like to invite views on the principles of CGT including whether its scope and reach in the context of the wider tax system continue to be appropriate.

Respondents are encouraged to think broadly but asked particularly to consider the themes identified in the Chancellor's letter including:

- Allowances, including the annual exempt amount its level and the extent to which it distorts decision making;
- Exemptions and reliefs, including how they fit together and the extent to which they incentivise some decisions over others;
- The treatment of losses within CGT, including the extent to which they can be used and whether the loss regime distorts decisions about when to buy or sell assets; and
- The interactions of how gains are taxed compared to other types of income, including how the boundary between what is taxed as gains rather than income works. Should there be different regimes for short-term gains, compared to long-term gains?

Many of these themes are also partly explored in the main body of the call for evidence so respondents may also wish to consider those elements that relate to structural issues, interactions with other taxes, and issues that affect business decision when responding to this section.

⁵ <https://www.ifs.org.uk/uploads/mirrleesreview/design/ch20.pdf>

Section 2: Main Call for Evidence

Introduction

The review aims to explore simplification opportunities across the following areas:

- the overall scope of the tax and the various rates which can apply
- the reliefs, exemptions and allowances which can apply, and the treatment of losses
- the annual exempt amount and its interactions with other reliefs
- the position of individuals, partnerships and estates in administration but not trusts or residence and domicile issues
- the position of unincorporated businesses, including the setting up, selling or winding up of such businesses
- the position of stand-alone owner-managed trading or investment companies but not the positions of large or group company structures
- any distortions to taxpayers' personal or business investment decisions
- interactions with other parts of the tax system such as Income Tax, Capital Allowances, Stamp Duty Land Tax (SDLT) and Inheritance Tax

This call for evidence explores structural CGT issues, challenges commonly affecting individual taxpayers, problems commonly affecting business owners and investors, the administration of CGT, the interaction between CGT and other taxes, and the wider CGT framework. Depending on an individual's personal circumstances there may be some overlap between these categories.

As outlined in the scoping document the OTS is looking for ways to simplify both administrative and technical issues, including identifying areas where the rules work can distort behaviour or appear not to meet their intended purpose. Suggestions could for example include ideas on how to rationalise processes, improve guidance, harmonise definitions, or make the framework or workings of the tax easier or more intuitive to understand.

When responding, it is extremely helpful if you can include practical real-life examples to illustrate any broader points. In addition, it would be helpful if you could outline your experience of the CGT system, and your role or roles in relation to it, for example:

- If you are writing in an individual capacity, how has the current CGT legislation or process impacted on you personally?
- If you are a business owner and considering the implications of CGT, what is your business activity, what is its size, and what form does your business take (unincorporated, corporate, partnership etc.)?
- If you are a professional advisor, what types of clients do you advise?
- If you are responding on behalf of a representative body or think tank, please describe briefly the body, its objectives and its members.

Structural CGT issues

CGT is broadly a tax on the difference between an asset's value when it is acquired and its value at disposal, less any allowable expenses. The main exception is when an asset was acquired before 1982, in which case its 1982 value is used instead of its acquisition value. Assets can be acquired through purchase, subscription, inheritance or as a gift, and are generally disposed of through selling or gifting.

Acquisition and disposal

1. Is the scope and boundary of CGT clear? Is it always obvious when an event is chargeable?
2. How generally aware are taxpayers of their (potential) CGT liabilities following a disposal? Could/should they be made more aware, and if so how?
3. To what extent do the current CGT rules influence decisions around whether, how or when taxpayers acquire or dispose of assets? And to what extent and how do taxpayers adjust their activity to reflect this?
4. Are there any specific practical challenges for taxpayers in dealing with the CGT aspects of acquiring and disposing of assets?
5. Is it always clear and easy to understand which expenses (including capital improvement, acquisition or disposal expenses) qualify for CGT purposes? Are the rules on qualifying enhancement expenditure clear and reasonably straightforward to operate in practice?
6. Are there particular practical challenges or issues arising from the CGT rules about acquiring, disposing of or transferring assets on marriage (or civil partnership), separation or divorce?
7. Are there particular issues around the boundary with income tax e.g. shares or share rights received by employees or the boundary between trading and investment?

Annual exempt amount (AEA)

The first £12,300⁶ of an individual's taxable gains in a tax year are taken out of capital gains tax through the AEA. The AEA increases annually by CPI inflation (rounded up to £100), unless overridden. The AEA has the effect of reducing the number of individuals who might need to report relatively small total amounts of taxable gains that accrue over a tax year.

8. In your experience, to what extent do individuals or their agents arrange to time disposals of assets in such a way as to maximise use of their AEA to manage down their tax liabilities?
9. Could there be a simpler or more targeted way of taking small gains out of tax?

Different rates of CGT (10%/20%/18%/28%)

The rate of CGT for individuals depends on several variables including their income tax position, whether a relief is claimed, and the nature of the asset being disposed of. Broadly the 18% and 28% rates apply to residential property and the 10% and 20% apply to most other asset classes.

10. To what extent do the different rates of CGT cause complexity? Is it always clear which tax rate should apply? Which situations present specific problems? Does the dependence on the income tax higher rate threshold make this inevitable? Do you think the rates position could be made simpler, and if so how?

⁶ Tax year 2020/2021, for individuals, personal representatives, and some types of trustee

Issues commonly affecting individual taxpayers

The questions below refer to certain key aspects of capital gains tax that may apply to individual taxpayers in their personal capacity.

Reliefs and exemptions

There are numerous exemptions and reliefs which create different tax outcomes depending on the value and nature of the assets that are being disposed of. Some of the exemptions may be regarded as simplifying by taking smaller gains out of the system, protecting revenue through disallowing potential capital losses (e.g. motor cars), or supporting a particular asset class (e.g. main homes).

Principal Private Residence Relief (PPR)

PPR supports owner occupation by taking most family homes out of the scope of CGT on most occasions. Although there are several exceptions the home must usually be the only or main residence of an individual during the relieved period. PPR generally applies from when someone has completed on their property rather than from exchange.

It is supported by a range of ancillary reliefs which cater for a small number of specific circumstances such as renovating the home for habitation, a delay in selling at the end of occupation, letting out a property, or moving elsewhere for work.

Where more than one property qualifies as a residence, it is possible to nominate which is treated as the main residence for PPR purposes.

11. Are you aware of situations where the current rules are not easy to operate perhaps because of changes in society or patterns of work (such as home-working, taking in a lodger, letting out a bedroom to tourists, or the use of gardens or grounds)?
12. Are the ancillary reliefs and occupation rules consistent with what you consider PPR is aiming to achieve? If not, what would make them simpler to apply or better achieve these aims?
13. How do you find the principle and practice of making a nomination? Are there better ways of achieving the same ends?

Chattels exemption

'Chattels' (e.g. a painting or a sculpture) are items of tangible, movable property, something that can be both touched and moved. Individual chattels acquired and disposed of for less than £6,000 are exempt. The chattels exemption is effectively a form of simplification for taxpayers, removing losses from the tax system alongside exempting small gains.

14. Are there any aspects of the taxation of gains arising from the disposal of chattels that you consider would benefit from being simplified?
15. Is it clear to taxpayers that gains on significant chattels are potentially taxable? Or is there a general lack of awareness?

Issues commonly affecting business owners and investors

The questions below refer to certain key aspects of chargeable gains that may apply to individual taxpayers in their commercial capacity (including owner managed businesses, unincorporated businesses, partnerships, corporate vehicles and their owners).

Business lifecycle

Key events in the lifecycle of a business may be considered to include start-up and incorporation, financing for growth, succession (passing on a business), and disposal or cessation of a business.⁷

16. Are there features of CGT that present barriers or distortions at any of these stages? Are the rules simple to understand and apply correctly? Please provide examples along with any suggestions on how the rules could be made simpler.
17. Do you know of occasions when CGT rules have affected business decision making more generally, including decisions regarding the structure of a business or the choice of business vehicle (for example a corporate entity, partnership, unincorporated business)?
18. Please tell us about any complications or rules which unduly affect the way businesses operate if payment for the sale of a business is not made in cash but in some other way (such as qualifying and non-qualifying corporate bonds, deferred consideration and earn outs). To what extent is there a business tension between claiming a tax relief at the point of sale as opposed to deferring the tax charge until cash is received?

Reliefs available to business owners/shareholders

A broad range of reliefs are currently available to business owners and shareholders, including:

- Business Asset Disposal relief (formerly Entrepreneurs' Relief (ER)) broadly allows qualifying business owners and certain types of employee shareholders to benefit from an effective 10% rate of CGT when they dispose of all or some of their business assets or shares.
- Investors' Relief (IR) is similar but extends the 10% CGT rate to external investors buying newly issued shares.
- Gift (hold-over) relief allows business owners to give away their business assets or to be paid less than they are worth without triggering a full or any tax charge on the disposer. The acquirer's CGT base cost is reduced by the gain attributable to the disposer.
- Incorporation relief allows business owners to transfer their business to a company in return for shares without triggering an immediate charge to CGT.
- Roll-over relief allows business owners to sell one business asset and reinvest the proceeds in another without triggering an immediate tax on chargeable gains.
- Disposal relief ensures shareholders do not have to pay CGT on a gain when they dispose of qualifying shares in certain venture capital investments (including the Enterprise Investment Scheme/Seed Enterprise Investment Scheme/Venture Capital Trust/Social Investment Tax Relief).
- Deferral relief which is available for Enterprise Investment Scheme and the Social Investment Tax Relief, supplements the previous bullet by allowing a person to treat a gain as not arising until some future date if they acquire qualifying shares. The gain may be charged to CGT in a later tax year, usually when they dispose of the shares.
- Re-investment relief fulfils the same function for the Seed Enterprise Investment Scheme but allows reinvested gains to be washed out entirely.

⁷ See for example the OTS Business Lifecycle Report 2018, which included consideration of some CGT issues

19. Is the scope of each of these reliefs intuitive or are there unexpected differences between them that create practical problems for businesses? Are there aspects of any of these reliefs that you consider are unclear or particularly difficult to utilise in practice?
20. Are there aspects of these reliefs which distort business decision making (for example in respect of such areas as the timing of the disposal of an asset, or how much cash to accumulate on a company balance sheet) or are inconsistent with your understanding of what the relief is aiming to achieve? Are there any ways in which they could be made less distortive?
21. Should gift relief be extended to cover a greater range of business and investment assets as it was until 1989? What would the effect of this be? And would any extension open up unintended avoidance opportunities?

Please refer to specific reliefs in your answer and provide illustrative practical examples.

Specific asset classes

As well as being subject to different rates of tax, different types of asset such as listed shares or investment properties often also have specific rules for CGT purposes.

22. Are there any aspects of the rules relating to the taxation of gains or losses realised on the disposal of shares and securities that are particularly complex to understand or apply? Are you aware of any difficulties in ascertaining the base cost of such assets, such as the share matching rules?
23. Are there any aspects of the taxation of gains arising from the disposal of investment properties, leases, land or buildings that you feel would benefit from being simplified?
24. Are there other asset classes (such as for example crypto assets) which present challenges or complexity for individuals on disposal?

Company issues

As incorporated and unincorporated businesses broadly share similar CGT rules the OTS does not expect that companies require a significant degree of separate consideration. However, there are some areas, such as the share matching rules, rebasing, and treatment of intangibles, where the rules have diverged.

25. Are there particular areas of complexity that relate exclusively to companies? And if so, should these be simplified or made more consistent?

Administration of CGT (for individuals, investors, and unincorporated businesses)

Administration

Individuals (both UK resident and non-UK resident) are required to report actual, and in some cases potential, CGT liabilities, and there are a number of methods through which they may be required to do this depending on what is being disposed of and the residency status of the person making the disposal.

From 6 April 2020, UK residents disposing of residential property (on which CGT is due) must use the new '30 day online service'. They must also report disposals of any other assets (e.g. commercial property, shares or 'chattels' such as paintings) through either the existing 'real time CGT service' or in an annual self-assessment tax return.⁸

Most non-UK residents disposing of any property will also move onto the new system although there are some situations where the existing arrangements are retained for less straightforward disposals and for disposals made by Personal Representatives.

This new system is in the process of being rolled out and we expect further refinements from HMRC over time.

26. Please describe any problems you have had (or anticipate having) in navigating the online systems or forms and provide any suggestions you have on how the forms or related guidance could usefully be simplified, made clearer or made easier to complete. Please specify which method(s) of reporting your experience relates to.
27. Do you have any suggestions about how HMRC could use information it currently has or has access to, in order to reduce administrative burdens, improve customer experience and ensure compliance in respect of individuals' and businesses' CGT obligations? Does HMRC get the balance right between asking for information to avoid unnecessary enquiries and streamlining the experience for those with simple affairs?

Payments

The timing of when CGT must be paid also depends on what is being disposed of and the residency status of the person making the disposal. There are several alternative ways through which to pay CGT including online or telephone banking, at a bank or building society, or by cheque through the post.

From 6 April 2020, all those required to use the '30 day online service' (whether UK resident or non-UK resident) have 30 days from the date of conveyance to pay any tax due. Where it is not possible to know the final tax figure at the 30 day date, a 'reasonable estimate' may be used, with any balance of CGT being due by 31 January following the end of the tax year in which the disposal took place.

The deadline for payment of CGT due on all other disposals is usually 31 January following the end of the tax year, though those using the 'real time CGT service' may pay earlier.

⁸ https://www.tax.service.gov.uk/capital-gains-tax-uk-property/start/report-pay-capital-gains-tax-uk-property?_ga=2.182178983.147975458.1591877008-818302390.1579076298

28. Please comment on any complexities or practical problems that you have experienced (or anticipate) in relation to the process of paying CGT. Please specify which reporting system(s) your payment(s) relate to.

Claims

Most reliefs, including relief for losses, must be actively claimed on the CGT tax return or by notifying HMRC directly. Capital losses must be claimed by 4 tax years from the end of the tax year of the disposal in order to be available for offset at any point in the future against any arising gain.

The OTS is currently carrying out a general review into claims and elections; however this does not specifically look at CGT claims.

29. Are you aware of any particular practical or technical issues (relating to for example record keeping, awareness, use of ringfencing rules, timing deadlines or other challenges) for losses, other claims, or clearances that you feel should be highlighted as part of this CGT review?

Record keeping, valuation and calculation of any tax payable

Individuals liable to CGT, as with other taxes, are generally required to retain sufficient records to work out their gains and keep them for at least a year after the self-assessment deadline (longer in some circumstances). Businesses need to keep records for at least five years from the self-assessment deadline.

30. What, if anything, could be done to help taxpayers to more easily fulfil their record keeping obligations and calculate any tax payable in relation to their capital gains?
31. Have you encountered any difficulty with valuing assets either at acquisition or disposal? What, if anything, could HMRC do to simplify the valuation requirements or processes without opening up unintended avoidance opportunities?
32. Would changing to a more recent rebasing date than 1982 make finding the base cost of a disposal easier or would any such benefit be outweighed by an increase in the number of valuations that would then be required?

Estates in administration

The period between the day of someone's death and the date the personal representative (executor or administrator) has ascertained the residue of the deceased's estate is known as the period of administration (unless there are disputes about the Will). During this period, the normal rules of CGT generally apply to the personal representatives, who are treated as having acquired the assets from the deceased at market value on death. The main exception is that that the AEA is only available for the first 3 tax years of the period of administration.

33. Are there particular aspects of the taxation of capital gains made by those administering an estate that could be simplified?

Interaction between CGT and IHT and with other taxes

The OTS report on Inheritance Tax (IHT) specifically looked at the interaction of IHT with CGT, and any distortions to decision making.⁹ The OTS concluded that the interaction between IHT and CGT is complex and can distort decision making, particularly when that decision involves when and how to pass on assets to the next generation.

34. To what extent does the absence of a CGT charge on death and transferring those assets at market value on death distort and complicate the decision-making process around passing on assets to the next generation?
35. Are there any aspects of the taxation of gifts or other disposals that are not made at market value, that you feel would benefit from being simplified? Should the range of assets eligible for a tax deferral when they are gifted be broadened to include a greater range of assets? And would any extension open up unintended avoidance opportunities?

Capital gains tax does not exist in a vacuum. The disposal or acquisition of a specific asset can trigger several different but interrelated taxes including Income Tax (particularly around employment related securities), Stamp Duty Land Tax, and Corporation Tax.

36. Are there instances where you feel the interaction of CGT with other areas of tax results in particular complexity or difficulty in applying the rules correctly? Are there definitions within CGT that would benefit from closer alignment with the definitions found in other taxes? Please provide examples, as well as any suggestions for ways to simplify the system.
37. Are there instances where you feel the interaction of CGT and capital allowances (in respect to income or corporation tax) results in particular complexity, difficulty in applying the rules correctly, or unexpected tax outcomes?

Other areas of complexity

38. Are there any particular areas of complexity that are unique to partnerships?
39. Please tell us about any other areas of complexity not covered above in applying any CGT reliefs, thresholds, or administration not already mentioned in your response, along with any suggested improvements to the CGT rules or legislation.
40. Are there any areas of complexity that are specific to England, Scotland, Wales or Northern Ireland?

Wider CGT framework

41. Do you think that there are ways in which the taxation of capital gains should be reformed more widely to simplify the regime for the benefit of taxpayers? If so, how?
42. Do you think it would be reasonable for some reliefs or exemptions to be removed if they fail to meet what you regard as their policy objective or are infrequently used? If so, which ones?
43. Are there any useful lessons that can be learned from the UK's historic CGT regime or other countries that would be relevant to the UK today? If so what, and from which countries?

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