Response to HMT/HMRC consultation on

"Implementing a capital gains tax charge on non-residents"

Here are my thoughts and suggestions on the questions asked in the consultation paper, plus a couple of other points. I have not responded to questions for which I have no information or views.

References below to a paragraph number are to that paragraph in the consultation paper. References to sections are to that section in the TCGA 1992.

Question 1: Would an exclusion of communal property from the scope of the new regime result in any unintended consequences?

I'm not aware of unintended consequences. I note in passing that student accommodation can be let for conferences etc during vacations. Such usage might suggest an proportion of any gain on disposal ought to be brought within the scope of the new charge. But I guess the government would favour the alternative view that the prime purpose of such accommodation is to house students and that is sufficient to conclude that it should remain exempt, as proposed.

On a point of detail, paragraph 2.3 doesn't specifically discuss the treatment of single properties (assets) that have had 'mixed use', whether it's the humble corner shop with a flat above it or, more likely, a substantial agricultural estate with a large farmhouse (or stately home) on part of the land comprised in the single asset in question. I presume rules will be included for apportioning gains/losses between residential and non-residential usage both of different parts of the property and of different residential and non-residential use over time.

Question 2: Are there any other types of communal residential property that should be excluded from scope?

I believe there's a case for excluding two other types of communal property, on the grounds that they are essentially 'accommodation to provide care', but wouldn't meet the explanation of that term in Box 2.A. The two types are:

1. Accommodation for person who are "learning disabled" and need 24 hour a day supervision/1-to-1 support for various reasons: it's no clear whether that would amount to "personal care" as referred to in Box 2.A
2. Certain probation hostels – technically called "approved premises" – used as short-term accommodation for ex-offenders who need constant supervision, for example, because there's a risk they may behave violently (to themselves or others): again, it's not clear such persons would be provided "personal care" as envisaged in Box 2.A.

I'm afraid I don't have detailed knowledge of these types of accommodation. But I will happily try to get a bit more information and, with luck, point you in the right direction if you would like me to.

By the way, I have no idea where "approved premises" will fit into the new probation etc. regime after the partial privatisation of the National Offender Management Service that the MOJ is currently taking forward.

Question 3: Are there any particular circumstances where including non-resident partners in scope of the charge might lead to unintended consequences?

None come to mind. Partnerships lend themselves to avoidance, for example through altering (capital) profit sharing ratios. I imagine it could be a particularly substantial risk if trustees (and personal representatives of deceased persons) were excluded from the scope of the new charge. But you will already be considering what rules will be needed in the package to counter those sorts of avoidance risk.

Question 4: Are there any particular circumstances where including non-resident trustees in scope of the charge might lead to unintended consequences?

I fully support the intention to include trustees of settled property within the charge (paragraph 2.11). The avoidance risk from not including them is far too great not to do so. I have identified only one downside to including trustees: it will add a significant amount of complexity to the rules, in order to ensure proper integration with the rules in sections 86/87 TCGA etc for charging settlors and beneficiaries on trustees' gains. But I'm afraid that extra complexity is simply unavoidable.

Question 5: Is a genuine diversity of ownership (GDO) test an appropriate way to identify funds that should be excluded from the extended CGT regime, and to ensure that small groups of connected people cannot use offshore fund structures to avoid the charge?

I don't know the detail of the GDO test, but it is sensible to follow an existing test if at all possible.

Paragraphs 2.12 to 2.18 don't discuss the 'double charging' or 'two tier' issue thrown up by imposing a charge on funds that fail the GDO test. Suppose the fund in question has a UK resident investor. When the investor disposes of their shares/units in the fund the disposal value will be enhanced by the amount of any gains the fund has made on UK residential property, net of the new CGT charge. But the investor will get no credit for the CGT that the fund has paid. The result is 2 tax charges on effectively the same gain: one on the fund and the second on the investor.

That result is no different from the position where a company pays UK corporation tax on its chargeable gains. However, the CGT rules for authorised unit trusts (AUT) etc are designed to ensure there is no 'double taxation' of this type. They achieve that by exempting the AUT from a CG charge (as paragraph 2.13 indicates). The issue is, therefore, whether an investor in a fund which is equivalent to AUTs should be given a tax credit for an appropriate part of any new CGT charge paid by the fund in question.

I haven't considered the point in detail, but suspect the right answer is "No". I believe that—
- Between the introduction of CGT in 1965 and 1971 or 1972 that AUTs **were** taxed on their gains and investors in the AUT were given credit for their share of the tax the AUT paid[1].
- **But** that system was abandoned (at least partly) because it was so unattractively complex.

Accordingly, the answer should be "No", because—
a. It would add yet more unwelcome complexity;
b. The only cases where a tax credit might in theory be appropriate would be where the fund was equivalent to an authorised unit trust **and** it also failed the GDO test; and
c. The number of cases involved are therefore likely to be too few and far between to justify the additional complexity.

Question 8: What are the likely impacts of charging gains (and allowing losses) incurred on disposals of residential property by non-residential property companies that are not already operating a trade in the UK?

I note only that there appears to be a possible interaction with the charge under section 13, where the non-resident company has UK resident participators. The best solution may be to disapply section 13 in the same way as for ATED-related gains (section 13(1A)).

Question 11: Which approach out of those set out in paragraph 3.5 do you believe is most suitable to ensure that PRR effectively provides tax relief on a person's main residence only?

The second approach looks unattractive, and I recommend against using it. At a fundamental level it goes against the grain of the concept of a 'main residence'. The main residence is not determined on the basis of a merely quantitative test. Rather, it is determined as a **qualitative**

[1] 1965-72 was before even my time in the Inland Revenue, but I recall seeing something about the system that operated then in the **old** CG Manual, which I trust you can still find if you want to look.

matter, evidenced only to an extent by quantitative measurements. Put more simply, "home is where the heart is" and the 'main residence' should be established on the same basis of where the heart lies.

A quantitative test could easily give inept outcomes. For instance, suppose Jane leaves her country cottage on Monday mornings, stays <u>four</u> nights in her flat in London where she works, and returns to her country cottage on Friday evenings, staying there <u>three</u> nights before returning to 'London the following Monday. A simplistic quantitative of where Jane has been present for most of the tax year could result in the London flat being treated as her main residence. But the fact of the matter is that Jane considers the flat to be merely a pied-à-terre, and her real home is the cottage. In short, the second test in paragraph 3.5 would give Jane the wrong result.

Furthermore, the second test could be <u>impossible</u> to operate in relation to spouses and civil partners, who can have only one main residence between them. A purely quantitative test could result in one residence being the main one of one spouse/CP and a different residence being the main one of the other spouse/CP. Any fair tie-breaker rule for this situation would be arbitrary and could be contrary to the reality of the particular case.

So we should rule out the second approach. But the first approach seems unnecessarily wide in its impact, because, as outlined in paragraph 3.5, it would apply to individuals whose residences are all in the UK. See Q12 for my recommendation.

<u>Question 12: Are there any other approaches that you would recommend?</u>

Given the weaknesses in the approaches in paragraph 3.5, I suggest that the right to nominate the main residence (section 222(5) should be disapplied <u>only where one (or more) of the residences is outside the UK</u>.

<u>Paragraphs 3.9-3.10 [rate of tax]</u>

The suggested approach seems contradictory. The AEA will be allowed, following the rule for UK residents. But the rate of tax (18%/28%) will be determined without regard to the individual's worldwide income (and gains), **not** following the rule for UK residents.

An alternative approach may be acceptable without excessive complexity. That would be—

- Allow the AEA, as proposed in paragraph 3.9;
- Charge non-residents' gains above the AEA at 28%;
- Allow non-residents to elect to be charged CGT (not withholding tax) at the rate that would have applied if they had been UK resident in the tax year in question.

The election would therefore allow non-residents to benefit from the 18% rate band, but only to the extent that a UK resident would. In practice most individuals liable to the new charge may well be comfortably above the 18% band and would therefore simply pay at the 28% rate, a perfectly fair outcome.

<u>Question 13: Do you believe that solicitors, accountants or others should be responsible for the identification of the seller as non-resident, and the collection of the withholding tax? If not, please set out alternative mechanisms for collection.</u>

I do not believe solicitors, accountants or others should be responsible for determining residency status. None of these players may have the necessary expertise in UK tax: for instance, UK solicitors are likely to be property specialists not versed in income tax and CGT rules; accountants may be – are perhaps quite likely to be – foreigners with little or no knowledge of the UK tax rules. Estate agents are equally unlikely to be UK tax literate. No other type of person comes to mind as a possibility.

I therefore conclude that the responsibility for determining residence status must remain with the individual, or body of trustees, etc, in question. They can seek advice from suitable experts as necessary.

See below for my thoughts on the collection mechanism.

Question 14: Are there ways that the withholding tax can be introduced so that it fits easily with other property transactions processes?

Question 15: Do you think that the government should offer the option of paying a withholding tax alongside an option to calculate the actual tax due on any gain made from disposal, within the same time scales as SDLT?

Question 16: Is it reasonable to ask non-residents to use self assessment or a variant form to submit final computations within 30 days? If not, what processes would be preferable?

1. The first issue in relation to a withholding tax is, "Who will get the money and be able to withhold the amount due?" The answer seems to be, "Only solicitors (or representatives acting in the standard solicitor's role)". Accountants and estate agents aren't necessarily going to get their hands on the money. You might try defining the person required to withhold tax in general terms – something on the lines of "any person who in the course of acting on behalf of the vendor/any of the vendors in relation to the disposal receives the whole or part of the consideration for the disposal". Something like that would encompass solicitors, but could also include accountants if they did in fact get involved in handling the disposal proceeds.

2. The above does not however deal with cases where there is no actual consideration for the disposal, for example, where it is a gift (to a relative etc). There's also question what to do with cases where the consideration is not in money form, e.g. a swap of one property (in the UK, and therefore subject to the CGT charge) for another (which could be in or outside the UK).

3. For simplicity the rest of these thoughts assume that—
   - a solicitor is acting and receives the cash due on the sale of the residence in question
   - there is only one vendor.

4. The first step should be for the vendor to certify to the solicitor that they are (or are not) UK resident for tax purposes. Note that this step will have to apply to **every** disposal of residential property by UK resident individuals and trustees (etc) and must be kept as simple as possible to minimise the additional bureaucracy. The person's UTR or NINO or other tax reference should be supplied where possible.

5. There may be another issue with this process of certifying residency. Unless the new rules for determining tax residence (which I have not got to grips with) put the position beyond doubt in all possible circumstances, it may be impossible for anyone, taxpayer included, to know for certain whether they are UK tax resident at the time of the disposal in question. If so, should people in that position be allowed to make a 'provisional declaration' of status, and how should such declarations be finalised?

6. You might also wish to consider allowing exemption from a withholding tax levy if the taxpayer certifies that, although they are not UK resident—
   - No part of any gain on the disposal will be a chargeable gain because it is **wholly** covered either by private residence relief or by relief for gifts to charities (section 257); or
   - They are not chargeable to UK CGT by virtue of another exemption (e.g. relief for charities under section 256); or
   - No part of the asset has been used at any time during the person's period of ownership for residential purposes. (Note: The solicitor would have to enquire about usage if the vendor doesn't make some declaration on these lines.), and just possibly,
   - The gain is wholly covered by allowable losses (already returned to HMRC?).

7. If withholding tax ['WT'] applies the solicitor must retain the appropriate amount from the disposal proceeds *net*, I suggest, of—

- Incidental costs of disposal (solicitor's and estate agent's fees); and
- Any amounts required to be discharged with the sale proceeds; this will include the amount required to pay off any mortgage on the property.

8. The second bullet under 7 could in theory leave insufficient cash to meet the WT due. But it still seems more in keeping with normal property transactions processes to allow deduction of mortgage etc charges first (see Q14). One could consider including an anti-avoidance rule preventing deduction of a mortgage if the amount was owed to a connected person. But that might add a complication that is not needed in practice.

9. The solicitor should pay the WT on or before the date by which the purchaser is required to pay any SDLT, or would be required to pay it if any amount of SDLT were due. I express it this way because—

- The date will be familiar to solicitors;
- They will have the money in time, so it's reasonable to require payment of WT by then;
- It is not possible to define a date for payment of WT by reference to, say, 30 days after the date of disposal because completion of the sale, including payment for the outstanding sale price, could take place around or after 30 days after the date of disposal as determined by section 28, leaving the solicitor without the proceeds to fund the WT payment or with an unreasonably short time in which to effect payment of the WT to HMRC,
- An alternative WT payment date of, say, 30 days after completion of the disposal could be abused by artificially delaying final completion. I understand the SDLT rules counter this by applying to the "effective date of completion".

10. A new obligation to render some sort of WT return, to include details of the vendor(s) will clearly be required as well as the obligation to pay WT. The return will presumably also have to made for the vast majority of UK property disposals in which there will be no WT liability, usually because the vendor is UK resident, so that HMRC can check cases where necessary. An obligation for the solicitor to render an WT account to the vendor may also be appropriate, so that the vendor is in a position to meet any obligations on them (see below). And, of course, HMRC will want to add the usual sorts of interest and penalty provisions for failures to comply one way or another.

11. I suggest vendors should use the usual Self Assessment machinery for reporting and paying CGT (or claiming back excessive WT). However a 30 day time limit (Q16) looks unworkable. CGT is a tax for a tax year and the new charge envisages allowing relief for losses on UK residential property. So if, for example, a gain arose on a sale in May it cannot be guaranteed that the taxpayer will know for certain what the CGT due is until after the following 5th April. They might realise an allowable loss in, say, the following February which reduces or wipes out any liability on the gain in May. The normal SA system and time limits therefore seem appropriate, not any shorter period.

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