Implementing a capital gains tax charge on non-residents: consultation

Comments by in response to the HMRC consultation document "Implementing a capital gains tax charge on non-residents", issued in March 2014

INTRODUCTION

1. The opportunity to comment on the consultation document "Implementing a capital gains tax charge on non-residents", issued by H M Revenue & Customs (HMRC) in March 2014 is most welcome.

2. I am happy to discuss any aspect of my comments and to take part in any further consultations on this area.

   Please contact me at

GENERAL COMMENTS

It has been long recognised that the UK's Capital Gains tax (CGT) treatment of non-trade related property that is:
(a) located in the UK; but
(b) owned by non-UK residents
is anomalous.

This is highlighted by Annex A of the consultation document.

An alignment of the UK's tax regime with those of its European neighbours is reasonable.

However there are some concerns over the methods that are proposed for the collection of the tax charge and the consequences for UK resident taxpayers who will lose an important right that currently reduces their compliance burden and provides a high level of certainty when calculating their tax liability under self-assessment.

I have expanded on these points in my answers to the specific questions, below.

RESPONSES TO SPECIFIC QUESTIONS

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

The exclusion of communal residential property from the extended CGT charge under the new regime seems to fly in the face of the first of the principles (fairness) that are supposed to underpin the changes.

Currently, in many cases, communal residential property is within the scope of CGT where the owner is a UK resident – for example nursing homes, privately run boarding schools etc. You make no case for a continued differential treatment of such establishments within the changes proposed. Clearly many communal residential properties are exempt from CGT where the owner is UK resident – for example private hospitals and boarding schools operated by charitable trusts; but not all such establishments are within the charity exemption, particularly where they are operated as part of a business. Under your proposal (for example) a privately run prison, operated by a UK resident company but owned by a non-resident trust would, effectively, be exempt from CGT if disposed of; whereas a similar establishment operated and owned by a UK resident company/trust would be subject to CGT.

To be consistent it would be appropriate to either extend the exemption (once the property types have been identified and defined) to all such communal residential property whether owned by a UK resident or non-UK resident; or extend the charge to all such non-UK resident owners.

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

No. The general scope of the "other institutions that are the sole or main residence of at least 90% of its residents" seems to cover types of accommodation that are not specifically mentioned. However the disparity in treatment mentioned above (in the answer to Question 1) seems equally evident in this generic class too. Similar establishments will still be subject to differing CGT treatment based solely on the residence status of the beneficial owner.

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

Provided that non-resident partners are able to access all of the reliefs, allowances and exemptions that are available to resident partners there are no obvious unintended consequences of the proposed changes.

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

As with partners, provided that non-resident trustees are able to access all of the reliefs, allowances and exemptions that are available to resident trustees there are no obvious unintended consequences of the proposed changes.

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?

Offshore fund ownership of residential property is an obvious way of avoiding the extension to the CGT charging regime proposed by these changes. Without some form of rule similar to a GDO test it is likely that further legislative changes would be needed to the new regime within a short time of its introduction.

On balance a GDO is the best way forward but I would have some reservations as to the likely complexity of such a rule, if it is to be comprehensively effective.

Question 6: Are there any practical difficulties in implementing a GDO test?

The tax compliance burdens on taxpayers are extensive. In order to implement a GDO test it is likely that an offshore fund would have a possibly extensive additional compliance burden in order to demonstrate its status under a GDO test. This issue is likely to interact with the imposition of a withholding tax regime for CGT on the disposal of residential property, particularly if solicitors or other professional advisers are responsible for operating it.

Question 7: Is there a need for a further test in addition to a GDO? If so, what would this look like and how would it be policed?

In the consultation document it is suggested that a "second-stage" test (for non-residential property) might be needed to supplement the GDO test. I think that this test should, in fact, be the primary test. If an offshore fund principally holds non-residential property (as defined) then there would be no CGT charge and there should be no need to apply a GDO test (which would then become the "second stage" test only if the majority holding is of residential property).

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?

It should be remembered that the mere fact that a non-resident company operates a trade in the UK through a permanent establishment will not automatically render its residential, non-trade related, investment property liable to a UK CT charge on gains resulting from a disposal of such property. With that in mind, in order to establish an effective CGT-type charge on such gains, a specific charge is most likely to meet the requirements of the overarching objectives for the new regime.

Question 9: Are there other approaches that you believe would be more appropriate to ensure that non-resident property investment and rental companies are subject to UK tax on the gains that they make on disposals of UK residential property?

As noted above in my answer to Question 8, some form of free-standing charge is likely to be most effective for levying the new charge on residential properties owned by non-resident companies. Whether this would be described as Capital Gains Tax (as with ATED-related gains), as Corporation Tax, or deemed to be Corporation Tax (as with the charge on loans to participators) is probably best determined in conjunction with some consideration of whether any particular description would produce problems with Double Taxation Relief available under Double Taxation Treaties.

Question 10: Are there any particular circumstances where changing the PRR election rules might lead to unintended consequences?

To the best of my knowledge no formal research has been done on the effectiveness of the current rules at TCGA 1992 sec 222(5)(a) (the "PRR election"). However experience and anecdote suggest that a great many disputes, regarding the availability of relief under TCGA 1992 sec 223, between HMRC and taxpayers have been avoided through the use of the "election".

If the facility to make the "election" is withdrawn I believe that a significant increase in litigation is likely.

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?

Both approaches will require a significant increase in record keeping on the part of taxpayers (and their advisers).

On balance a carefully legislated rule that focuses on a taxpayer's actual behaviour (option 1) would seem to be fairer on the body of taxpayers at large – but individual circumstances can vary so much and it is possible that any overly simplistic formulation will impact adversely on some taxpayers with odd, unusual (or bizarre) personal circumstances that are currently not problematic with the availability of an "election".

Question 12: Are there any other approaches that you would recommend?

Yes.

I consider that the ability to serve a notice under sec 222(5)(a) should be retained. However to address the concern that a non-resident individual might use the "election" to thwart the purpose of the new regime I would propose that the right to make the election be restricted to individuals with a sufficient connection with the UK. This could be described objectively as a specified number of years of UK-residence status (not unlike the process associated with the right to claim the remittance basis of taxation). Thus, non-UK residents would be ineligible to serve the required notice and their residential property status would be determined objectively.

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.

Given the context of the proposed new charge, those professionals involved in the conveyancing of residential property are the most likely to be effective in the reporting of transactions and potential CGT (and CGT-like) charges. Most professionals will have had to determine their clients' residence status for Money Laundering and "know your client" purposes – although such residence determination will generally not be accomplished using the rules for statutory residence under the Taxes Acts. Similarly those professionals are in the best position to be responsible for the collection and payment of any withholding tax. Extensive and clear guidance (produced in conjunction with the relevant professional bodies) would be essential.

However this would be a significant additional responsibility for such professionals and great care would be needed in the formulation and implementation of any penalty regime for breaches (particularly inadvertent breaches) of the new rules – particularly in the early years.

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

This could present some operational difficulties.

For example; would withholding tax be due when there is any payment whatsoever, including any deposit (including refundable), payments to secure the right to preferential treatment in a bidding or negotiating process, payments into an escrow account that are not immediately available to the vendor, amounts withheld (e.g. on account of works to done) etc?

To avoid claims that (for example) a conveyancer has failed to collect the withholding tax the rules concerning the "trigger point" for withholding would need to be clear, explicit and capable of operating in the real world.

Any withholding tax system must fit well into the current conveyancing regime. Close consultation with property law specialists will be essential.

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?

In my experience there is a low correlation between the final sale proceeds of a property and its eventual chargeable gain and the tax eventually due.

It would be unfair if the vendors of residential property, which might be subject to a withholding tax, were unable to pre-empt that flat rate charge with an accurate computation of the actual chargeable gain.

This is not a unique proposition in the matter of property taxation. In the case of non-resident landlords, the withholding tax on rents paid can be pre-empted by a full disclosure of the landlord's UK tax position.

See my response to Question 16. A possible solution to the tension between these two possibilities might be the use of a withholding tax rate that is lower than the rate of CGT.

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?

30 days is a tight time limit, particularly when non-residents are involved. A process involving the submission of a provisional return within 30 days and a final return later might be feasible although there are clear revenue-protection issues involved since in some cases there would be an advantage in the submission of an artificially low initial estimate of the tax due. Such considerations might outweigh the reasonableness of having an alternate computational method to the simplicity of a withholding tax.

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