Chartered Institute of Taxation

Excellence in Taxation

**Implementing a capital gains tax charge on non-residents: Consultation Response by the Chartered Institute of Taxation**

## 1 Introduction

1.1 The CIOT comments on the consultation: Implementing a capital gains tax charge on non-residents.

## 2 Executive summary

2.1 The overarching objectives for the new charge are defined as:

'*Fairness: the primary aim of the new regime is to ensure that the tax treatment of non-residents that own and make gains on UK residential property is comparable to that of UK residents.*

*Sustainability: the new regime will be introduced in a way that can be maintained without risk of significant abuse going forwards.*

*Simplicity: the new regime will be introduced in a way that minimises complexity as far as possible.*

*In practice, the Government notes that it will need to balance these different objectives against each other in deciding on the appropriate design for the extended capital gains tax regime.*

The CIOT notes that given that the concept of 'fairness' means different things to different people, the use of this concept as an overriding objective is problematic: it raises as many questions as it answers.

2.2 While we note the stated need to balance such potentially conflicting objectives, experience suggests that in the pursuit of avoiding abuse (referred to as 'sustainability' by the consultation) and/or achieving 'fairness', simplicity is often compromised. Our concern is that the proposed new charge is likely to add to the costs and compliance burdens of residential property transactions for individuals and business. For example,

ARTILLERY HOUSE
11-19 ARTILLERY ROW
LONDON SW1P 1RT

Tel: +44 (0)844 251 0830
Fax: +44 (0)844 579 6701
E-mail: technical@tax.org.uk
Web: www.tax.org.uk

a gain arising on the disposal of UK residential property by a non-resident company potentially may fall within the scope of the proposed new CGT charge from 2015, ATED-related CGT from 2013-2015 (assuming that ATED related CGT is abolished from April 2015) and trigger the imputation provisions (TCGA 1992 sections 13, 86 and 87) in relation to gains accruing before 2013.

2.3 The most effective method of importing simplicity into the CGT regime governing the taxation of non-residents owning UK residential property is for ATED-related CGT to be abolished altogether from April 2015. As a result, all acquisitions of UK residential property post April 2015 (the current proposed date for the introduction of the proposed new CGT charge) would be governed by the proposed new charge.

2.4 Some thought needs to be given to the applicable rate of tax. We note that rate differentials are already part of the existing system in that the lower corporation tax rate (and indexation) applies currently to chargeable gains realised by a company that is outside the ATED regime. For reasons of EU law the application of the higher 28% ATED-related CGT rate applies to both UK and non-UK resident companies. Similarly any rate differential in relation to the extended charge between a resident and non-resident is likely to breach EU law. Therefore it may be simplest for the legislation to set out the parameters for the application of the charge and then to provide that the tax borne by the person falling within those parameters is determined by the legal form of that person eg companies fulfilling the criteria for the application of the proposed new charge are chargeable to corporation tax (at corporation tax rates) in respect of those gains and individuals fulfilling the criteria are chargeable to capital gains tax (at capital gains tax rates).

2.5 Also with simplicity in mind, past measures have resulted in situations where there are subtly different definitions of residential property for SDLT, ATED, FA 2004 Schedule 29A (investment-regulated pensions), CGT, CGT-related ATED, Business Investment Relief for non-domiciliaries, capital allowances and VAT. We think that consistency of definitions would be a considerable improvement. Subtle variations between definitions of residential property depending upon the tax or context make it difficult to discern the underlying policy and set traps for the unwary.

2.6 In terms of the delivery mechanism, we think that using the self – assessment process with the normal due dates is by far the preferable approach.

## 3 Consultation process

3.1 This consultation was published as a stage 2 consultation and is open over a 12 week period. During the consultation period, HMT and HMRC have held a number of workshops on specific areas (principal private residence, withholding, funds and corporates, international aspects and defining residential property). We are in favour of such workshops as part of the consultation process. However, it would be helpful for future consultations if workshops could be held earlier in the 12 week consultation process (or perhaps as part of informal consultation before the issue of the formal consultation document) with dates announced when the consultation is issued so that discussions taking place or announced at the workshops can be factored in to the written response to the consultation.

## 4 Re-basing

4.1 We understand that historic gains will not be within the scope of the proposed charge. However the method by which such gains will be excluded remains under consideration. Possibilities include a rebasing for valuation of properties as at 1 April 2015 for companies or 5 April 2015 for trustees or individuals, or a form of pro- rating of the capital gain over the period of ownership.

4.2 Our preference, subject to the comments below (at paragraph 9.4), is for rebasing at April 2015. Any form of pro-rating or time apportionment over the whole period of ownership is likely to effectively bring part of pre April 2015 gains into charge which runs counter to the fairness aim. In addition the application of time apportionment to expenditure incurred for the purpose of enhancing value and reflected in the asset at the time of disposal would require a further pro-rate apportionment rendering the calculation more complex. However, we recognise that re-basing carries a compliance cost (mainly valuation). For that reason and to cater for cases where time-apportionment would lead to a lower taxable gain, we think there should be an ability to elect for a time apportionment basis.

4.3 Only post April 2013 ATED-related gains or losses are relevant when working out the charge to ATED-related CGT. However, TCGA 1992 Schedule 4ZZA provides for an irrevocable election, the effect of which is to ignore that and instead use the pre April 2013 value (31 March 1982, or the date of acquisition if later) as the base cost for calculating the gain rather than rebasing. It is unclear how a form of pro-rating over the period of ownership in relation to the extended CGT charge might interact with this election.

4.4 The simplicity of the CGT charges relating to transitional situations would be enhanced by the abolition of ATED-related CGT.

## 5 Encouraging de-enveloping

5.1 The consultation contains a number of references to the Government's intention to discourage corporate enveloping through the existing ATED charge and related measures including ATED- related CGT. We have commented previously on the underlying rationale for introducing the package of measures announced at Budget 2012 (the 15% higher rate of SDLT, ATED and ATED – related CGT). We attach as an appendix our concerns around the extension of its scope in Finance (No 2) Bill 2014 to properties worth £500,000 and above.

5.2 We reiterate that given that one of the aims of the package of measures was to encourage de-enveloping, there needs to be a mechanism to incentivise taxpayers to do so without potentially incurring significant tax costs ( without any funds generated to meet those costs). The tax costs of extracting a property from an envelope include CGT and potentially SDLT where there is debt secured on the property. The reduction in value will bring in many more properties into the scope of ATED and related measures and the opportunity should be taken to encourage the unwinding of such structures in a tax –neutral way.

5.3 Conversely, there remain a number of people who want to use a company or other structure because they do not want to become involved in UK probate. Consideration might be given to the creation of a vehicle which would be completely transparent for all UK tax purposes but non-UK situs for probate purposes while also providing a degree of confidentiality for holders (other than in relation to governmental bodies).

## 6 What is meant by residential property

6.1 Provided that definitions meet the policy objective, we consider that definitions should be, as far as possible, consistent across the taxes. There is a danger of making distinctions in the tax system for barely discernible reasons, thereby creating traps in application. The current position is unsatisfactory in that there are at present different definitions of residential property for the purposes of SDLT, ATED, FA 2004 Schedule 29A (investment-regulated pensions), CGT, CGT-related ATED, Business Investment Relief, capital allowances ('a dwelling- house') and VAT.

6.2 We note that the VAT Information Sheet 02/14[1] provides some helpful expanded guidance particularly the first paragraph that refers to a 'dwelling' as self- contained living accommodation including the basic elements of living (kitchen, bathroom, living and sleeping area).

6.3 The consultation document at para 2.6 gives a list of exclusions from the charge. We note that if the policy intent is to exclude communal residential property, it would be preferable for the exclusions to be framed in this way rather than by way of examples. Experience suggests that a list of defined exclusions carries with it the potential for disputes and uncertainty in relation to facts that are at or approaching the perceived boundaries of those exclusions.

6.4 Para 2.3 of the consultation notes that the Government intends to focus the proposed new CGT charge on property used or suitable for use as a dwelling ie a place that currently is, or has the potential to be, used as a residence. It is stated that this will include property that is in the process of being constructed or adapted for such use, in line with the definition in the ATED regime.

6.5 We have commented in previous submissions on the SDLT guidance on 'suitable for use'. Both the SDLT manual (at SDLTM20076 [2] and see the Stamp Taxes Bulletin 2/2012) and the ATED technical [3]guidance (at para 19.2) suggest that an existing building that is being 'adapted **or marketed'** (our emphasis) for residential use is likely to be treated as suitable for use as a dwelling. In the case of a building where the last actual use was commercial, we do not agree that the marketing of a property to a developer or to potential end user purchasers as residential should in itself render it 'suitable for use as a dwelling' unless construction or adaption works have begun to

---

1 http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageVAT_ShowContent&propertyType=document&id=HMCE_PROD1_033065

2 SDLTM20076 states that:

'Use at the effective date of the transaction overrides any past or intended future uses for this purpose. If a building is not in use at the effective date but its last use was as a dwelling, it will be taken to be 'suitable for use as a dwelling' and treated as residential property, unless evidence is produced to the contrary.

Undeveloped land is essentially non-residential but may be residential property if, at the effective date, a residential building is being built on it.

Where, at the effective date, an existing building is being adapted or marketed for, or restored to, domestic use, it is treated as residential property.'

3 http://www.hmrc.gov.uk/so/ated-tech-guide.pdf

convert the building. The legislation does not support the interpretation set out in the SDLT manual and ATED technical guidance.

## 7 Ownership through trusts and interaction with related anti- avoidance provisions

7.1 It is not clear how the new charge will interact with the attribution of gains of non-resident settlements and matching rules (TCGA 1992 sections 87 and 87A).The CIOT notes that there is merit in simplicity and that such simplicity will be promoted by as far as possible achieving a single system of taxing non-resident trust gains in respect of residential property from April 2015. We think this is best achieved by the extended charge applying to non- resident trustees with no rebasing – ie the full capital gain should be charged on the trustees. However, to avoid unfairness there should be the option for trustees to elect for a pre-2015 gain to form part of the TCGA 1992 section 2(2) amount ie the net chargeable gains of the trust.

7.2 Accordingly, the legislation should make clear that any gains realised post April 2015 do not form part of the pool of trust gains whether directly or by virtue of attribution under section 13 TCGA. There is precedent for this approach eg in the interaction of TCGA 1992 sections 86 and 87 where section 87(4)(b) provides that section 86 chargeable gains are not included in the pool of trust gains/ section 2(2) amount. A similar approach could be adopted in respect of the proposed new CGT charge.

7.3 Turning to the trustee borrowing rules in Schedule 4B and 4C TCGA, we note that, where, post April 2015 but before the actual disposal of the property, Schedule 4B would otherwise apply to trigger a deemed disposal giving rise to deemed gains, it is necessary to ensure that those gains are not taxed twice ie once on the beneficiary in respect of benefits received if the deemed gain goes into the Schedule 4C pool and again on the trustees when they make an actual disposal of the property.

7.4 Subject to our comments below on PRR, we consider that the relief in TCGA 1992 section 225 (private residence occupied under terms of settlement) should be available to non- resident trustees. Currently if a non- resident trust has a UK property occupied by a beneficiary entitled to occupy it, then there is no amount to impute to the settlor under TCGA section 86 or section 86A and/or no section 2(2) amount for section 87 purposes because had the trustees been UK resident then section 225 relief would have been available to them. That presumably will still be the case. We consider that the section 225 relief should continue to frank the trustees' own (post 2015) gains (assuming that the property is indeed the main residence of the beneficiary).

## 8 Ownership through fund structures

8.1 In terms of the charge at fund level, we are in favour of using existing authorised funds legislation and the offshore funds rules to develop a genuine diversity test to exclude widely held funds.

## 9 Ownership through companies

9.1 The CIOT notes that the simplest way of implementing the proposed new regime is for the new rules to set out the parameters for chargeability and to state that, where the disponor falls within the stipulated parameters, the charge to be borne by the disponor will be governed by the tax regime that applies to that disponor. In other words, a company that comes within the parameters of the proposed new charge will be chargeable to corporation tax in respect of the post April 2015 gains and an individual or trustee who comes within the parameters of the proposed new charge will be chargeable to capital gains tax at the marginal rate applicable to the individual and trustee (respectively). This would ensure that the proposed new charge dovetails into the existing systems of tax applicable to such persons while at the same time ensuring that there is not a rate differential in respect of the gains per se but only in respect of the legal form of the disponor.

9.2 We note that the foregoing is not the Government's preferred approach: the preference is for a 'tailored' one (which the CIOT understands to mean a self-contained mini-code to deal with gains realised by non-residents on disposal of UK residential property). However, the CIOT notes that there is little detail in the consultation on what this means other than that losses incurred on disposals of UK residential property would be available to offset a gain and the rate of tax is yet to be determined. It is not clear whether the losses will be available for offset against gains on UK property or any gains realised by the company. Consideration needs, in our view, to be given to the position of a non-resident company which realises losses in one year and in a subsequent year operates in the UK through a permanent establishment and realises gains: does the Government envisage that the losses are available for offset against these subsequent gains?

9.3 Further, careful consideration needs to be given to the structure of the mini-code in order to ensure that it does not contravene the EU's fundamental freedoms (in particular, the free movement of capital) and the non-discrimination clauses in many double tax agreements with non-EU territories.

9.4 We note that the Government's proposal is that the ATED – related CGT will apply in priority defaulting to the wider charge where it does not apply. However, in the interests of simplicity and coherence of the structure and operation of the taxation of chargeable gains, the CIOT urges the Government to abolish ATED related CGT for disposals from April 2015. Such gains would be within the scope of the proposed new charge CGT charge on non-residents and there is no need for the complication of an additional system of charge (ie ATED related CGT) which covers a part of the gain. We recognise that for companies or other non- natural persons already within the scope of ATED the abolition of ATED- related gains coupled with a rebasing date of April 2015 would allow gains accruing April 2013 – April 2015 to escape tax. Our preferred solution is to address this issue via variable rebasing dates[4] rather than by parallel regimes. Therefore :

- for most non-residents the rebasing date would be April 2015

- for structures caught by ATED the rebasing date would be April 2013

- rebasing will not apply in the computation of the imputation provisions of sections 13, 86, 86A, 87 or 89

For the latter two categories, however, there should be the ability to elect for the pre 2015 gain to be charged (under ATED related CGT if the regime is retained or CGT as appropriate) or imputed instead, with only the post 2015 gain charged on the non-resident. In the case of the imputation provisions this would be a joint election with whoever the pre 2015 gain was imputed to.

[4] Or variable dates for time-apportionment if our suggestion of an election is taken-up

9.5 The retention of ATED related CGT will impose considerable complexity. For example for companies, a gain arising on a disposal by a UK resident company may already fall to be treated as partly under the ATED-related gains regime and partly as a non- ATED related gain depending upon different values and usage of the property. The ATED-related gain attracts the higher CGT rate of 28% on the ATED-related gains while any portion of gain that is non ATED-related is charged at the lower rate of corporation tax and also benefits from a notional indexation relief deduction. Therefore the ATED-related CGT charge already involves an undesirable dual charging structure and a differential rate. With the introduction of the proposed extended CGT charge for a non-resident company, there will be a further 'tailored charge' operating in tandem with ATED-related CGT with the potential for even more intricacies if pre- 2015 gains are pro-rated rather than re-based to April 2015. A non-resident company could move in and out of the ATED-related CGT charge depending on the use of a property from time to time.

9.6 Our strong preference is to reduce complexity by abolishing the ATED-related CGT charge altogether albeit (as discussed above) with an earlier re-basing date for companies within the scope of ATED.

## 10 Ownership through partnerships

10.1 In accordance with the proposal above we are in favour of a single system of taxing partnership gains and the abolition of ATED-related gains for partnerships within ATED. An earlier re-basing date would need to be put in place to capture gains in the period April 2013- 2015. Therefore gains on UK residential property attributable to non-resident partners would need to be re- based to April 2013.

10.2 The extended charge brings into sharper focus the issue of determining the nature of foreign entities (whether transparent or opaque) particularly as entities that are funds which satisfy a genuine diversity of ownership test will be excluded from the charge.

10.3 There may be consequences for hybrid partnerships (where the UK treats an entity as transparent but a foreign country treats it as opaque) or for a reverse hybrid partnership (where the UK treats the entity as opaque but the foreign country treats it as transparent). In a sense that is not a new problem as it can exist already and double tax relief does not always work properly. However, imposing a CGT charge on non-residents for the first time may bring it to the fore as there will be a whole range of entities which previously would not have had to consider the problem.

10.4 As a first step we suggest that a list is compiled of those entities where this mismatch could occur. The list would need to reflect current entities.

## 11 Private Residence Relief ( PRR)

11.1 We recognise the Government's concern that a non- UK resident individual's ability to elect a UK residence as their main residence under TCGA 1992 section 222 could undermine the new charge and therefore a solution is sought. We emphasise that the withdrawal of the election is a much wider issue, affecting UK residents with two homes, not just non-UK residents with residential property in the UK. Abolishing the election will lead to considerable compliance costs for the, admittedly relatively small proportion, of taxpayers who have more than one residence and for whom it is not clear which the main one is or was.

11.2 The consultation proposal to withdraw the election has created much uncertainty over the effect of any election currently in force or one made in the lead up to April 2015. We think the better approach would have been (and still is) to consult separately on this issue.

11.3 If the ability to elect is ultimately withdrawn, there appear to be a number of possibilities for the transition:

1. Abolish the election from 6 April 2015 but elections in place continue to apply for the property specified, but the election once made is irrevocable (no flipping).

2. A variation on (1) to allow a change of property under elections made before 6 April 2015.

3. Abolish with retroactive effect such that existing elections apply only until 6 April 2015 but from 6 April 2015 a property will only remain a main residence if it is a main residence on the facts.

4. Abolish with retrospective effect such that from 6 April 2015, existing elections would be treated as never having been made so for both past and future years it will be a question of fact.

The CIOT would strongly oppose option 4. The CIOT's recommendation is also to choose an option that is not retroactive (ie option 3).

11.4 However, we do not necessarily accept that the solution lies in the total withdrawal of the ability to elect. The ability to elect exists to meet the need, in circumstances where an individual has more than one residence, of determining which is the main residence thereby avoiding undesirable uncertainty. This issue still arises even where one residence is owned and the other one is rented.

11.5 Two examples from the CGT manual illustrate the effect of withdrawing the ability to elect for UK residents:

- An individual who works in London during the week and who stays in rented accommodation, but also owns a home elsewhere which he or she uses as his main residence at weekends and during holidays (See CG64500).

- An individual living in job-related accommodation but who has an interest in a dwelling that he intends to occupy as his main or only residence (see CG64555).

If the ability to elect is removed altogether, it is possible that PRR would be denied for these individuals (under one of the proposed alternatives at para 3.5 of the Condoc) because the rented accommodation may be considered to be the main residence.

11.6 In the examples outlined where the second property is held by way of short lease, one partial solution might be to introduce a presumption that PRR is available for the property in which a substantial ownership interest eg a long lease or freehold which is the only property owned by either member of a married couple and which is occupied by them during the year whether or not as their main residence. The majority of people would not need to make the election and this would be an improvement on the existing position where some are forced to elect a property simply because they rent somewhere else for the majority of the week and spend most of their time there eg for work purposes. We note that the term 'substantial interest' would need to be statutorily defined.

11.7 If an individual has two residences, and the ability to elect is removed, the consultation puts forward two alternatives at para 3.5. The first approach is a qualitative one, based on all the evidence, and is similar to the current position. The second offers a fixed rule based on presence necessitating the keeping of records. A problem with the second approach is that a UK resident would have a more onerous obligation than at present. Any move to a factually-based test would also need to find some method of dealing with married couples/civil partners. In both cases the periods of absence provisions in TCGA section 223(3) would need to be preserved to protect those working full time abroad for a few years.

11.8 The extension of main residence relief for periods of absence is in need of some reform if the ability to elect for a UK property to remain as a main residence during a period of absence is withdrawn.

The exemption in section 223(3)(a) applies only to individuals working full time abroad and performing all of their duties outside the UK. This is out of step with the modern world and also with the Statutory Residence Test (SRT) which allows for up to 30 days of UK work per tax year. We suggest that in the interests of consistency and simplification, anyone who meets the definition of full time working abroad under SRT should be allowed the benefit of the exemption.

In addition, the definition of periods of absence, by means of which the exemptions in section 223(3)(a) to (d) all apply, within section 223(7) indicates that the taxpayer may have an interest in no other residence. This goes far wider than requiring him to own a second property, and indeed ESC D21 as copied below for ease of reference suggests that even employer provided accommodation may constitute enough of an interest in a second property to prevent exemption from applying, unless an election is made.

*D21 Private residence exemption: late claims in dual residence cases*
*Where for any period an individual has, or is treated by the Taxes Acts as having more than one residence, but his interest in each of them, or in each of them except one, is such as to have no more than a negligible capital value on the open market (eg a weekly rented flat, or accommodation provided by an employer) the two year time limit laid down by TCGA 1992 s 222(5)(a) for nominating one of those residences as the individuals main residence for capital gains tax purposes will be extended where the individual was unaware that such a nomination could be made. In such cases the nomination may be made within a reasonable time of the individual first becoming aware of the possibility of making a nomination, and it will be regarded as effective from the date on which the individual first had more than one residence.*

If the facility to make an election is to be withdrawn the law related to periods of absence also needs to be redrafted so that individuals whose interest in any second property remains of negligible value can be confident the law will continue to allow them an ongoing exemption.

11.9 A further alternative is that the ability to elect is retained for all but would only be effective if a person is present in the property on at least 91 days (or 91 midnights using the SRT definition of day). Using 91 days has two advantages. First it allows weekend homes (104 days of weekend less, say, 7 weekends for holidays) still to be elected as the main residence for those who are in the 'week-in-the-city-weekend-in-the-country trap'. Second, if a person is in the house for 91 midnights then automatically he or she will have a 90-day tie (year-on-year) and an accommodation tie for SRT purposes. That will in most cases (leavers definitely and arrivers if they have one other tie) result in UK residence (but without amending the SRT). Increasing the day count to 121 days would catch arrivers as well, but would operate adversely for those who spend weekends and no other time at all in the country home. The main disadvantage of this approach is the imposition of a record–keeping obligation that is inherent in any day count test but might be regarded as the 'price' for making the election. Nor does it address the fact that a treaty might grant the other country taxing rights (as explored further below). However, 90 or 120 days would be a good proxy for working out whether something was really a 'main' residence and it is also a good if not perfect deterrent under the SRT. It has the key advantage that the election remains available to all in circumstances where determining which residence is the main residence as a matter of fact is difficult. A carve out would be required for those working abroad.

11.10 A further possibility that could be considered is to retain the ability to elect for all but to amend the statutory residence test (SRT) such that if at any point during the tax year there is an election in force that a residence in the UK is a person's main residence, then that person is to be treated as being automatically UK resident for that year with the exception of those qualifying under the third automatic overseas test (FTWA). We recognise an understandable reluctance to amend the SRT regime so soon after it has been introduced but we consider that such a modest amendment would be fairly straightforward to achieve.

The rationale is that electing a property as the main residence is tantamount to saying that one's home is in the UK and offers the advantage of retaining the existing ability to elect for UK residents. Although under the model OECD model treaty (article 4) the tie- breaker provisions for residence could mean that an individual resident in both the UK and another state is resident in the other contracting state despite having elected a residence in the UK to be his or her main residence, the individual would still need to make a declaration to that effect having regard to the terms of the particular treaty which in itself is likely to act as a deterrent. In addition the tie- breaker provisions do not override the fact of UK residence for purely domestic law purposes: in particular they do not remove the obligation to complete tax returns and to fulfil similar obligations imposed by the Taxes Management Act. Nor will such persons be protected in all cases from a charge on remittances or under TCGA 1992 section 87.

## 12 Delivery mechanism

12.1 Although we recognise that withholding tax is used as a collection mechanism for gains realised by non- residents in other jurisdictions, we do not support the introduction of a withholding tax mechanism because of its likely adverse impact on UK residential property transactions. Where debt is secured against the property a sale cannot take place unless the seller's solicitor provides undertakings to the buyer's solicitor that the proceeds will be used to pay off the loan and procure a release. Immediately after completion the seller's solicitor is under an obligation to pay all or part of the proceeds to the seller's mortgagee (depending on the level of debt) to comply with the undertaking. A withholding tax would mean potentially competing claims on the proceeds in respect of the payment of withholding tax and the obligation to pay funds to the mortgagee. In other jurisdictions the requirement to withhold may be built into the lending levels such that the amount lent reflects the fact that withholding is in priority to repayment.

12.2 In addition a collection agent, such as the seller's solicitor, may not have the information or the specialist knowledge to establish the correct taxation liability or indeed whether a liability exists at all, or, more significantly, the residence status of the seller and /or the nature of the property, whether residential or commercial. Determining residence status is not straight forward and may not be possible at all part way through a year of assessment. Determining the nature of the property for the purposes of the obligation to withhold is similarly difficult and would require a very clear definition to allow the seller's solicitor to apply it without fear of reprisal. The consequence is likely to be increased costs in the transaction in engaging specialist advice.

12.3 The imposition of the obligation to withhold on a third party differs from a situation where it is imposed directly on one party to the contract or transaction (eg the non- residents landlord provisions). In the latter case any dispute with HMRC over the fulfilment of that obligation can be resolved via the tribunal. A third party will bear in addition the risk of challenge from their client if the obligation is not fulfilled correctly.

12.4 We note, also, that a gift of property or a deemed disposal would obviously involve no proceeds from which to withhold.

12.5 We note also the extensive powers for cross- border recovery under the Mutual Assistance Directive and via double tax treaties to enforce compliance.

12.6 An alternative suggestion might be for some form of advanced payment filed within (say) 30 days from the date of transaction on the basis that the obligation rests with the seller. However if the obligation rests with another person, some of the same difficulties would arise as for withholding (for example, establishing residence and property status). It is unlikely that a short period of a month or so would be sufficient to establish liability.

12.7 Our preference is for the CGT to be collected via the normal self – assessment process including the requirement to notify and the filing of a self- assessment return by the normal due date of 31 January following the year of assessment in which the gain accrues.

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

13.1 The main difficulty lies in arriving at a clear definition of what is within the scope of the charge and what is excluded. As we note above, a list of defined exclusions carries with it the potential for disputes and uncertainty in relation to facts that are at or approaching the perceived boundaries of those exclusions.

13.2 One option might be to utilise the Town and Country (Use Classes) Order 1987 (as amended). The Use Classes order distinguishes between dwelling houses, whether used by a single household or as a house in multiple occupation (classes C3 and C4) and various categories of residential institution.

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

14.1 We have no comment.

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

15.1 As noted above, the extended charge brings into sharper focus the issue of determining the nature of foreign entities. There may be particular consequences for hybrid partnerships (where the UK treats an entity as transparent but a foreign country treats it as opaque) or for a reverse hybrid partnership (where the UK treats the entity as opaque but the foreign country treats it as transparent).

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

16.1 As noted above, it is not clear how the new charge will interact with the attribution of gains of non-resident settlements and matching rules (TCGA 1992 s.87 and 87A, Schedule 4B and Schedule 4C).

16.2 As explained above, we consider that TCGA 1992 section 225 relief should continue to frank the trustees' own (post 2015) gains (assuming that the property is indeed the main residence of the beneficiary).

**17 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?**

17.1 We are in favour of using existing authorised funds legislation and the offshore funds rules to develop a genuine diversity test to exclude widely held funds.

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

18.1 It will depend largely upon the nature of the test.

**19 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?**

19.1 No further comment at this stage as it will depend upon the nature of the GDO test.

**20 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?**

20.1 As set out above, the introduction of a 'tailored charge' operating in tandem with ATED-related CGT will impose considerable complexity with the potential for even more intricacies if pre- 2015 gains are pro-rated rather than re-based to April 2015. A non-resident company could move in and out of the ATED-related CGT charge depending on the use of a property from time to time.

**21 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?**

21.1 Our strong preference is to reduce complexity by abolishing the ATED-related CGT charge altogether albeit (as discussed above) with an earlier re-basing date for companies within the scope of ATED.

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

22.1 As identified above, the withdrawal of the election is a much wider issue, affecting UK residents with two homes, not just non-UK residents with residential property in the UK. Abolishing the election will lead to considerable compliance costs for the, admittedly relatively small proportion, of taxpayers who have more than one residence and for whom it is not clear which the main one is or was. There are also transitional issues to consider for elections already in place.

**23 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?**

23.1 Of the two approaches, the first is a qualitative one, based on all the evidence, and is similar to the current position. The second offers a fixed rule based on presence necessitating the keeping of records. A problem with the second approach is that a UK resident would have a more onerous obligation than at present. In both cases the periods of absence provisions in TCGA section 223(3) would need to be preserved to protect those working full time abroad for a few years.

23.2 Our preference is for the ability to elect to be retained and an alternative approach adopted to guard against HMRC's concerns ( see question 12)

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

24.1 As set out above we have suggested alternative approaches.

**25 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.**

25.1 As explained above, we do not support the introduction of a withholding tax mechanism because of its likely adverse impact on UK residential property transactions.

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

26.1 No, as above at Q13.

**27 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?**

27.1 No, our preference is for the CGT to be collected via the normal self – assessment process including the requirement to notify and the filing of a self- assessment return by the normal due date of 31 January following the year of assessment in which the gain accrues.

**28 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?**

28.1 As above at Q15.

**29 The Chartered Institute of Taxation**

29.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 17,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
20 June 2014

**APPENDIX**

**Finance (No 2) Bill 2014**

**Clauses 103-105: Annual Tax on Enveloped Dwellings (ATED) and SDLT: reduction in thresholds**

**Government proposals**

**Clauses 103 and 104** introduce two new bands for ATED:

Residential properties worth over £1 million and up to £2 million will be brought into the charge with effect from 1 April 2015. The charge for these properties in 2015-16 will be £7,000.

Residential properties worth over £500,000 and up to £1 million will be brought into the charge with effect from 1 April 2016. The charge for these properties in 2016-17 will be £3,500.

**Clause 105** extends the 15% SDLT rate applied to residential properties purchased by companies, partnerships that include a corporate partner and collective investment vehicles (collectively referred to as 'non- natural persons') to properties purchased for over £500,000 with effect from 20 March 2014. [5]

Essentially these measures extend the scope of the package of measures announced at Budget 2012. The original package was targeted at enveloped[6] residential properties worth more than £2m. The FB clauses 103-105 extend the measures to enveloped residential properties worth more than £500,000.

[An appendix to this note sets out our concerns around the underlying policy rationale of the original package.]

**CIOT concerns**

**Encouraging de-enveloping**

The Government notes that ATED has raised 5 times the amount forecast for 2013-14, with significantly more properties above £2 million in envelopes than expected. [7]

The most likely reasons for residential property to be held in an 'envelope' are to mitigate inheritance tax, or for reasons of anonymity, or because of foreign jurisdiction rules on forced heirship. ATED does not encourage de-enveloping because there are often tax costs (CGT and potentially SDLT) associated with taking property out of the envelope. In our view the explanation for the unexpectedly high revenue lies in part in the decision to retain property within the envelope for the reasons cited and therefore to pay an ATED charge as the cost of so doing. Given that one of the aims of the original package was to encourage de-

---

[5] The Government will also extend the related CGT charge on disposals of properties liable to ATED for residential properties worth over £1 million and up to £2 million with effect from 6 April 2015 and for residential properties worth over £500,000 and up to £1 million with effect from 6 April 2016. Legislation on the CGT elements of this measure will be introduced in Finance Bill 2015.

[6] Enveloping in this context means putting a high value residential property into an (usually) offshore, company or other holding vehicle and selling the shares or other interest rather than the underlying property to escape SDLT and potentially stamp duty.

[7] Para 1.193 HM Treasury 2014 Budget Report

enveloping, a significantly higher revenue yield might be legitimately regarded as evidence of the failure of that original policy aim.

The CGT position also works against the aim of encouraging 'de-enveloping'. Not only may there be a CGT cost in extracting the property, but if a non-resident individual were to sell shares in a non-resident company holding a high value property (despite the practical due diligence difficulties in doing so) that individual would not be subject to either the existing ATED – related CGT or to the new CGT charge (as currently proposed[8] ). CGT will only apply if the company (or other non- natural person) disposes of the property. Therefore such an individual can theoretically sell the shares free of CGT creating a perverse incentive to keep the property within the envelope and overcome the not inconsiderable practical obstacles to selling shares rather than the underlying property.

If the Government is serious about encouraging the removal of property from an 'envelope', we reiterate that there needs to be a mechanism to incentivise taxpayers to do so without potentially incurring significant tax costs (without any funds generated to pay these costs). The tax costs of extracting the property from a holding structure include CGT and potential SDLT costs where there is debt secured against the property.

**Administrative burdens**

The scope of ATED means that genuine commercial business (eg those trading in, developing or letting residential property, or carrying on a farming business) are caught within the charge and only removed by claiming one of the reliefs through the filing of an annual return. The government has recognised the additional administrative cost for an estimated 8,000 corporate businesses that buy or hold residential properties worth more than £500,000 that will now incur an additional administrative burden in having to file a return within the prescribed time limits in order to claim relief from ATED. We welcome the proposed consultation on reducing this burden. It is important that steps are taken to ease the compliance burden for those smaller businesses newly within the charge as a result of the reduction in thresholds that will need to claim relief.

**Indexing and bands**

In terms of thresholds, we oppose cliff edges. The introduction of new bands and therefore the increased scope for valuation disputes at the thresholds is undesirable.

The charging bands are not indexed (although the actual amounts payable are increased by reference to CPI). The failure to index the bands means that the new lower bands will catch even lower value properties as house prices rise.

[8] Implementing a capital gains tax charge on non- residents: consultation https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298759/CGT_non-residents_condoc.pdf

## APPENDIX

### Policy rationale: background note

The stated aims of the original package were i) tackling SDLT avoidance, ii) ensuring that individuals and companies pay a 'fair' share of tax on such property and (iii) encouraging 'de-enveloping' ie encouraging property holders to transfer the property out of the holding entity and instead hold it directly.

In response to the original package the CIOT made clear its fundamental reservation that although SDLT avoidance clearly needed tackling, it was not the enveloping of property that was the problem because enveloping was not used to any great extent for SDLT planning. What needed addressing was the proliferation of marketed SDLT schemes. We welcome the fact that HMRC have taken firm steps to address actual SDLT avoidance since 2012, particularly in relation to mass marketed schemes. HMRC have been actively pursuing such schemes through enquiries and litigation. In addition Finance Act 2013 section 194 and Schedule 2A re-wrote the legislation dealing with sub-sales and other transfer of rights with the aim of counteracting schemes. We consider that these measures have been far more effective in combatting avoidance than the introduction of, and the proposed extension to, ATED and the higher SDLT rate.

The reason why enveloping is not used to avoid SDLT is because It is commercially too difficult to save SDLT by selling the shares in an offshore company holding high value residential property because of the extent of due diligence required. The purchaser of the shares inherits all the tax liabilities and legal history of a company. It is extremely costly to identify all undisclosed liabilities particularly in the absence of audited accounts. At values below £2m it is scarcely credible that enveloping is used for SDLT avoidance.

The inference drawn is that the extension of ATED to lower value residential property is therefore at heart a revenue raising measure. If so, it should be recognised as such in the interests of transparency. It is important that the policy objectives of new measures bear examination, not least because the need to consider the principles upon which legislation is based is now enshrined in the General Anti- Abuse Rule [9].

[9] FA 2013 section 207 – in considering whether an arrangement is abusive regard is to be had to the principles on which the provisions are based and the policy objectives of those provisions.