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20 June 2014

Our ref: PCS/WJID/MR

Dear Sirs

Implementing a capital gains tax charge on non-residents

We welcome the opportunity to feedback our comments on the proposed extension of Capital Gains Tax ('CGT') to non-residents who dispose of UK residential property, as set out in the consultation document published on 28 March 2014 (which we refer to as 'non-resident CGT'). We would however like to stress that the proposed changes to Principal Private Residence ('PPR') relief, if enacted, will constitute a substantial change to the taxation of UK residents, potentially operating in an unfair manner. We are therefore of the view that the proposed changes to PPR relief should be subject to a separate consultation in order to ensure that the impact on UK residents is fully considered. Nonetheless we have included in our response comments on the proposals contained within the consultation document.

We have included detailed responses to the consultation in enclosed Appendices, but to summarise, our key comments are:

- Given the overriding principle of the current proposals is creating 'fairness' between UK residents and non-UK residents, the taxation of UK and non-UK residents should be the same. In particular, non-UK resident companies should pay a rate of CGT equivalent to the prevailing corporate tax rate and indexation allowance should be available.
- ATED-related CGT should be abolished, as it results in needless complexity and following the extension of CGT to non-UK residents, we assume is unlikely to raise significant extra revenue than would be collected through non-resident CGT alone.
- The Consultation Document states that 'the charge will come into effect in April 2015 and will only apply to gains arising from that date. We suggest that taxpayers should be able to elect to use the market value of their properties in April 2015 when calculating any post-April 2015 gain or loss arising. This is consistent with rebasing in other areas.
- Relief for UK-residential property capital losses should be available against all UK-residential property capital gains, and we suggest it should be possible for those excess capital losses to be carried forward and relievable against non-UK residents' future capital gains.
- Abolishing PPR elections would be unfair in some cases, significantly increase complexity and produce significant administration requirements, for both taxpayers and HMRC.
- We suggest that either i) non-UK residents should be able to make a PPR election if they elect to be UK

resident for tax purposes or ii) PPR elections should be retained for EEA residents, but abolished for non-EEA residents. Due to the often retrospective nature of the statutory residence test, and the fact that internationally mobile employees have frequently changing residence status, we have suggested that all individuals and trustees should be able to make PPR elections, but an election should only be effective where it relates to an individual's period of UK residence.

- The government could consider introducing a minimum occupation requirement, such that only properties which are used for a minimum period of time during the tax year would be eligible to be a PPR. We have suggested a minimum period of 30 days presence in the property per tax year, as this would be consistent with the second automatic UK test in the Statutory Residence Test ('SRT'). This is also relevant when considering homes in other areas of the SRT, such as whether a foreign property is an individual's home. Appropriate relief would need to be introduced for a property which is normally a PPR not being used as such, for example, due to illness of the taxpayer or because the taxpayer is caring for sick relatives.
- We also suggest that rental properties from which taxpayers do not derive any capital value (i.e. properties rented using shorthold tenancies) should be statutorily excluded from being eligible residences for PPR purposes, as the current position causes needless complexity for individuals who, say, rent a flat near to work but own a home which they use at weekends, or where the periods of absence provisions are in point.
- Gains subject to non-resident CGT should be removed from charge on the relevant interested parties under s13, s86 or s87 TCGA 1992, though it should be possible for non-resident gains to be matched to trust beneficiaries without further tax charges arising. We have suggested amending s87 to allow 'franked' gains to be matched.
- We consider that it is viable for a genuine diversity of ownership test to be applied for funds, though have suggested some adjustments to make maximum use of the existing tax system (in particular, the close company test, modified for the 'institutional investor' relaxation in the UK REIT regime) and to take account of joint venture/co-invest arrangements. We have summarised our suggested approach in the form of a flowchart.
- We also suggest that CGT group relief should be available on intra-group transfers of UK residential property, regardless of the residence of the companies within the group, since the gain on eventual disposal of the property to an unconnected person will remain within the UK tax net.
- We support an exclusion from non-resident CGT for communal residential property, as to do otherwise could reduce investment into communal residential property in favour of commercial property investments (as investments of this kind would be less commercially attractive for foreign investors). Assuming the intention behind this exclusion is to support investments which serve a social and economic function, we suggest that accommodation which is provided for children and students, which is used to provide care or which is used largely by employees should be excluded from the scope of non-resident CGT (at least whilst used for that function). This exclusion could be based both on the property design (e.g. halls of residence, where individual rooms would fall short of being separately identifiable as dwellings) and also on the actual use of the property. The use test could be by reference to a specified use (e.g. where local authority consent has been granted for multiple occupation, and where consent is required to change use) or based on who is actually using the property in question (on a look-back basis). A usage test should be capable of using existing test currently applied (e.g. council tax exemptions for student occupation).
- We understand from our discussions in the working groups that the government favour a self-assessment payment on account system, instead of withholding tax administered by conveyancers and associated advisers, and so have only commented on the former. We do however comment that it is not possible for advisors, to certify residence as i) residence status on a given date may be subject to a later date and ii) advisors are unlikely to have sufficient evidence to do so.

- We suggest payments on account should only be required where the vendor ceases to be liable to UK tax and there is a high-risk of non-compliance. If payments on account are used, it will be essential that the payments due can be calculated without reference to the actual gain arising (since we recommend that normal time limits should apply to self-assessed gains). We suggest that payments on account should be calculated based on sale proceeds using either i) a fixed percentage rate ii) a fixed percentage adjusted depending on duration of property ownership or iii) by reference to an index of property values. Option i is the simplest to calculate but also the least accurate, option iii is the most accurate but is also the most complex to calculate, and option ii is the middle option is terms of both complexity and accuracy. A 30-day requirement may be viable, provided both the calculation and administration are straightforward.
- We have also commented on reporting and request that, wherever possible, non-resident CGT reporting is incorporated into existing self-assessment forms.

We would be happy to discuss the above in more detail, in a meeting if you would prefer. We would also like to be involved in any further working groups which are organised to discuss the proposals or draft legislation.

If you would like to contact us, please contact the undersigned or

Yours sincerely

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Enclosures:

Appendix 1: Answers to consultation questions

Appendix 2: Calculating gains and losses

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Appendix 1: Answers to questions in consultation document

Residential property

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

Where property is being used for commercial purposes, and is let to occupants or to a service provider, investors are primarily motivated by the income and capital returns generated by the property. Whilst a distinction is made between 'commercial' and 'residential' under UK planning law, tax legislation and everyday parlance, the distinction may be blurred where the property is not available for owner occupation. Where properties, in their current use, are unavailable for owner occupation, they then often fall to be considered as 'commercial' properties by investors and developers.

Foreign investors accounted for over 50% of real estate investment transaction in the UK in 2013. Those investors are increasingly sophisticated and, as part of their investment decision making process, look at the net (after tax) income and capital returns from their investments.

If foreign investors are appraising two UK investment opportunities, where one is subject to UK capital gains tax but the others is not, this is may lead to a distortion in their allocation capital. This in turn may lead to an underinvestment in those asset classes.

On this basis, it is crucial to appreciate the possible economic consequences from introducing a tax on particular asset classes, especially where there is a social and economic driver behind the provision of the asset supply (e.g. student housing).

The exclusion of communal residential property from the charge would put it on the same tax basis as UK commercial property, and therefore should remove a potential distortion. On this basis, we do not envisage that the exclusion should have any unintended consequences.

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

Communal residential property can be seen across a number of different sectors, from schools and nursing homes to student housing and sheltered housing. If the underlying driver behind excluding communal property is that is serves a social and economic function (and can be distinguished from owner occupied property), then the categories of property that satisfy this definition should be expanded / made clear:

- Accommodation for children and students
- Accommodation to provide care
- Other communal property where institutions or their employee account for a significant proportion, such as accommodation for nurses.

The definition of communal residential property could be two-fold:

- Design: only capable of being occupied by specific persons (e.g. halls or residence, care home, hospice), and where the design of the building leaves each individually identifiable 'residence' as being short of a 'dwelling'. . A building should be considered only based on its current and past design, and no consideration should be given to the future possible adaption of the building.

- Use: where the design means that it is capable of being used by owner occupiers, but is actually used by specific person (e.g. students, elderly, and those in need of personal care).

A use test could be met through a number of different assessments, which could be driven by social and economic policy. For example, this could be:

- where the property is tied to a particular institution (such as a university, for halls of residence, or a care provider);
- where regulation restricts the usage of the property (e.g. a particular 'use' class in the local authority permitted uses, or where regulated care is provided to occupants); and
- Where the property is actually used by a group of occupants that meet the policy conditions (e.g. students, which could in some cases be demonstrated by an annual exemption from Council Tax).

In the case of a use test the expectation would be that the property would not be completely excluded from the charge if it failed to mean the relevant condition, but rather that it would only be the gain realised during that period of non-excluded use that would be taxed.

We envisage that in the case of a property being converted from commercial to residential, it will be necessary to include an apportionment of the gain realised such that it is only the capital appreciation during the period of residential use that it subject to the tax.

A use based apportionment above could therefore also be accommodated (on a look-back basis).

Different forms of residential property ownership

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

On the basis that partnerships are transparent entities, we assume that the tax position of the partners will be the same as though they had owned UK residential property directly (i.e. individual partners would be required to pay CGT but collective investments which satisfy the appropriate requirements to be outside the scope of non-resident CGT should not). This seems reasonable.

In accordance with *Memec v IRC* [1998] BTC 251 and consistent with stamp duty land tax, we suggest that firms or entities which are of a similar character to the partnerships listed in SDLTM33110 should be regarded as partnerships for the purposes of non-resident CGT, in which case the partners should be chargeable on any gains arising, rather than the partnership itself. It would be helpful if a list of foreign entities on which HMRC has considered partnership status could be published, comparable to the list of transparent/opaque entities for income tax purposes in INTM180030. Alternatively, it would be helpful if this list could be extended to apply for CGT purposes.

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

Ss86 and 87 TCGA 1992

Where trustees own properties directly, gains are already attributed to UK resident, UK domiciled settlors of trusts under s86 TCGA 1992 (assuming the other conditions for s86 to apply are met). Gains which are realised by offshore trustees in cases where s86 does not apply may be subject to CGT when matched to capital payments received by UK resident trust beneficiaries under s87. In cases where s86 applies and beneficiaries other than the settlor receive capital payments, those beneficiaries may be taxable at a later date if s86 ceases to apply and the trustees subsequently realise gains which are not chargeable on the settlor, and are therefore available to be matched under s87 (e.g. if the settlor dies).

As non-resident trustees will be brought within the scope of CGT by non-resident CGT, in order to prevent double taxation, any gains subject to non-resident CGT will either need to be removed from the scope of s86 and s87, or, if they remain within the scope of these areas of legislation, credit will need to be available for tax paid by the trustees.

In our view, the simplest option would be to remove gains subject to non-resident CGT from charge under s86 and s87, as this would result in only one person needing to report and calculate the tax due on the gain. In most cases we would not expect this approach to significantly change the tax payable, though this will depend on the extent to which the annual exemption and lower rate bands of CGT are available, and in some cases the CGT payable may increase where, say, two settlors within the scope of s86 would otherwise each be taxable on 50% of the gain arising, and so under current rules each of the settlors would be able to utilise his or her annual exemption.

We do however suggest that it would be equitable for gains subject to non-resident CGT to be available for matching as previously taxed gains when matched to capital payments received by beneficiaries. As the trustees will have paid tax on the gain, it seems to us that it would be fair to allow trust beneficiaries to receive 'franked' capital payments where tax has been paid (similar to the approach taken for tax credits on UK source and certain foreign dividends). This would of course involve amending s87 in order to add franked non-resident gains to the trust pool and to consider how such franked gains would be matched with distributions.

S13 TCGA 1992

Likewise, we suggest that any gains which are chargeable on non-resident companies under non-resident CGT should be removed from the scope of s13 (which would include all gains on disposal of residential property which is acquired from April 2015). This would align with the approach for ATED-related CGT (though for the reasons set out elsewhere in this letter, we suggest ATED-related CGT should be abolished). Where the company is owned by non-resident trustees, we suggest the same franking mechanism should be extended to apply to non-resident gains chargeable on the underlying company which are subsequently matched when capital payments are made by trustees.

Trustee borrowing (Schedules 4B and 4C TCGA 1992)

In addition to s86 and s87 TCGA 1992, Schedules 4B and 4C apply in certain cases where trustees with outstanding borrowing make transfers of value. Consideration will need to be given to gains which may inadvertently enter the Schedule 4C pool if ss86 and 87 TCGA 1992 are amended. Our suggestion is for deemed disposals of residential property to be excluded from Schedules 4B and 4C from April 2015, on the basis that otherwise double taxation would occur on an actual disposal of the property, otherwise there would be a genuine unfairness.

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Ownership through fund structures

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?

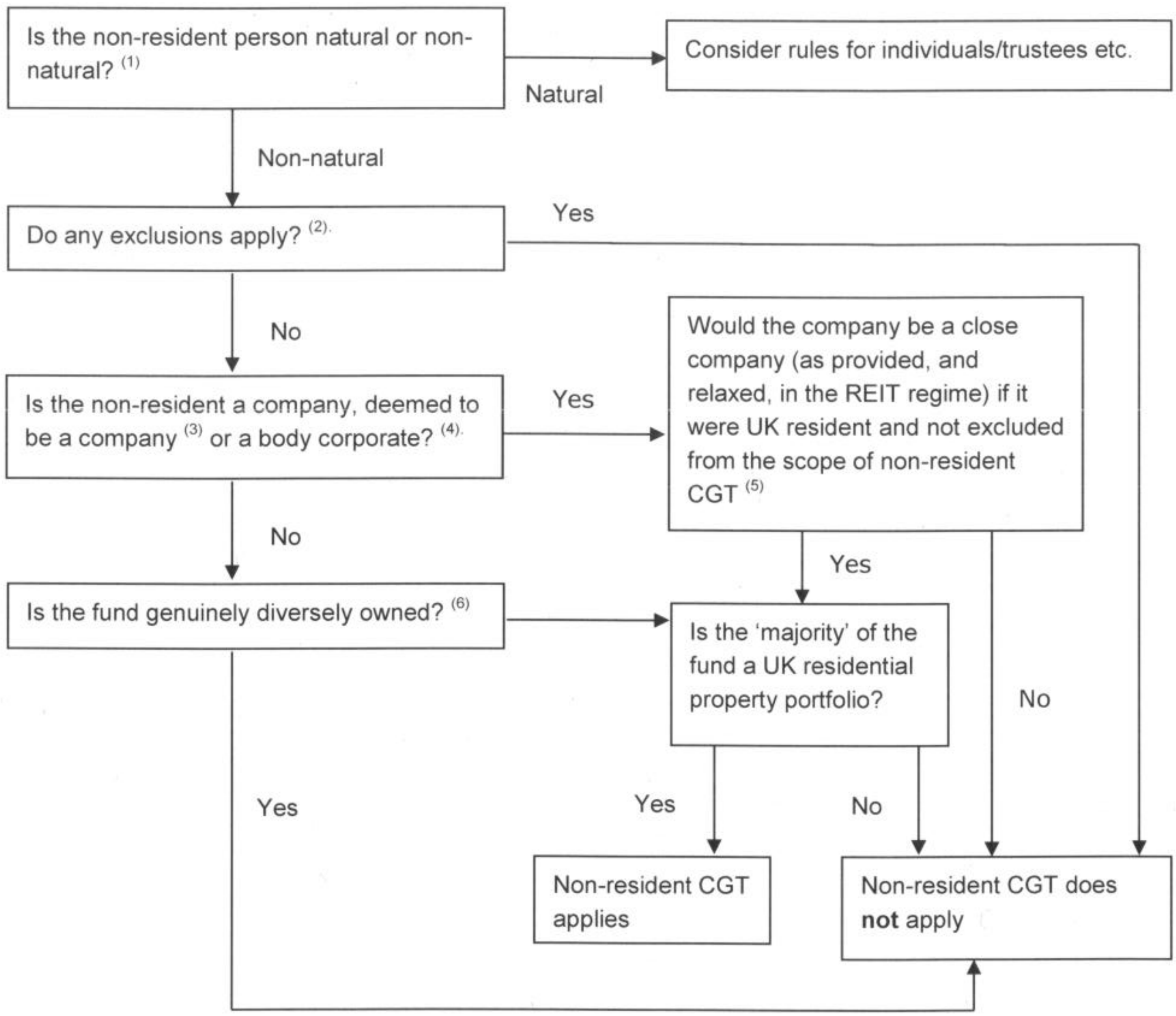
Question 6: Are there any practical difficulties in a GDO test?

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?

We have consolidated our answers to questions 5-7 and, instead of commenting on the funds referred to in the consultation document in isolation, have commented on collective investment schemes generally, and other widely held corporate ownership structures, as we believe the scope of fund taxation is better considered in this context.

Firstly, we would like to state that we agree with the principle that the funds themselves should, in general, be required to calculate and pay any CGT arising on disposal of UK residential property as for the majority of commercially available funds with a significant number of investors, it would be far too difficult administratively to determine who the non-resident investors are (particularly where capital entitlements may vary over the life of the fund), for the investors to calculate and report the gains arising and for HMRC to cost-effectively enforce payment of tax by the investors.

We also consider that it is possible to construct a practical GDO test taking account of the existing framework in the tax system, and have set out a suggested mechanism for this below in the form of a flowchart which takes into account the different types of entities which may be used as collective investment vehicles.



Notes to flowchart:

1) This could mirror the ATED definition, whereby companies, partnerships with one or more corporate members and certain collective investment schemes are non-natural and all other entities are natural. This includes individuals, trustees and partnerships without corporate members, the tax position of whom we have considered separately in the relevant sections of this response.
2) This relates to specific exclusions from non-resident CGT to be included in the new legislation. In particular, we understand from the consultation document that REITs and pension funds will be excluded from the scope of non-resident CGT. We suggest that the government consider introducing an exemption based on the 'REIT institutional investor list' in s528A CTA 2010, such that an exemption should be available to certain institutional investors including charities and life-assurers. We also suggest the government consider including exemptions for other entities which are exempt from the ATED, including public bodies, bodies established for national purposes and (potentially) properties where a conditional exemption from inheritance tax is available.

3) Certain entities are deemed to be body corporates for CGT purposes, such as unit trusts (s99 TCGA 1992) and certain offshore funds (s103A TCGA 1992 et seq). For consistency, we suggest no exceptions are made from this approach for the purposes of non-resident CGT.
4) As suggested in our answer to question 3 in relation to partnerships, we suggest the character of foreign entities should be assessed using the approach in *Memec v IRC*. Tax Bulletin 70 contains a list of non-UK entities which HMRC have previously accepted as bodies corporate. It would be helpful if HMRC could expand this list to set out other entities which it has considered and found to be other types of entity (e.g. partnerships).
5) We envisage this definition mirroring s13(1) TCGA 1992, though in order for this test to be appropriate, the close company rules in s438 CTA 2010 et seq. should be modified so that:
    a. The associate test in s448 CTA 2010 would need to be amended so that members of a partnership, who are unconnected aside from their interests in a partnership, should not be deemed to be connected with one another for these purposes.
    b. Institutional investors should be accommodated when determining whether a company is regarded as close. This is on the basis that institutional and large groups of investors often enter into joint venture or co-invest arrangements when investing in UK property and therefore we suggest the relaxation in s528(4A) CTA 2010 should be extended to apply in this context.
6) The existing definitions which apply to UK authorised investment funds (Regulation 9 SI 2006/964) and to offshore funds (Regulation 75 SI 2009/3001) could be applied here.

<u>Ownership through companies</u>

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?

Extending CGT to UK residential property investments might adversely affect the level of investment made by overseas investors into UK residential property. They may either choose to invest in non-residential property in the UK instead (please refer to our answer to question 1 above), or potentially not invest in UK property at all.

Our comments relate to how UK tax payable by non-UK resident companies should be calculated and the extent to which relief for losses will be available (we assume that double taxation relief will be governed by the UK's network of double taxation treaties or unilateral tax relief in the absence of such a treaty, so have not commented on this further).

Following the introduction of non-resident CGT, gains realised by a non-resident company on disposal of a residential property could potentially be subject to taxation under three different tax charges; i) UK resident individuals may be subject to CGT on pre-April 2013 anti-avoidance provisions such as ss13, 86 and 87 TCGA 1992; ii) post-April 2013 gains may be subject to ATED-related CGT if relief from the ATED is either unavailable or not claimed, for example, during a period where the property is occupied by a shareholder of a property owning company and iii) post-April 2015 gains may be subject to non-resident CGT where relief from the ATED has been claimed, e.g. where a property is let to third parties on commercial terms. The position may be even more complex depending on the method chosen to provide relief for pre-April 2015 gains, as i) if the value on April 2015 is used, two valuations would be required – one for April 2013 and another for April 2015 and ii) if a method other than valuation is used, the gain between April 2013 and April 2015 would need to calculated using some other method.

Given that, from April 2015, the intention is for CGT to be payable by all non-UK residents on disposal of UK residential property regardless of the use to which a property has been put, we question the merit of retaining ATED-related CGT given the obvious complexity and additional administration caused by applying three different tax systems to the same gain, and also question how much revenue would be raised from ATED-related CGT in excess of the tax which would be raised if ATED-related CGT were instead replaced with non-resident CGT. We have considered this in further detail in Appendix 2.

As gains on disposal of UK residential property will be chargeable irrespective of residence, it seems to us that capital losses should also be allowable against gains realised on disposal of UK residential property.

Where companies are members of the same group, intra-group transfers of residential property between group companies will not result in assets leaving the UK tax net, as any gain on disposal of the residential property will remain chargeable in the UK regardless of the residence of the transferee. We therefore suggest that group relief should be available for intra-group transfers of residential property, which would require s171 TCGA 1992 to be amended in respect of transfers of residential property.

Similarly, we suggest that s171A elections should be available in respect of UK residential property gains and losses, irrespective of the residence of the companies concerned, provided the other conditions for s171A elections to be available are met.

Question 9: Are there any 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?

Our suggestions are included in the relevant sections of this letter and we have no further suggestions to add here.

<u>Principal Private Residence ('PPR') relief</u>

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

The proposed abolition of PPR elections for UK residents will be of extremely significant impact. The ability to make a PPR election where there is more than one available residence provides fairness, certainty and administrative simplicity. If the ability to make PPR elections is to be removed from UK residents, we are of the view that a separate consultation should be held to fully consider the issues arising from this.

Despite our preference for a more detailed consultation on PPR relief, we have set out our comments on the proposals in relation to PPR relief and issues arising from the current drafting of the legislation in the remainder of this section of our response.

In order to ensure fairness in the system, the government should consider changing the treatment of shorthold tenancies from which the tenants do not derive any capital value but which are nevertheless regarded as interests in residences for PPR relief purposes. A residence that the individual occupies under a tenancy is an eligible residence, even though it is extremely unlikely that the disposal of such an interest could give rise to a capital gain. Where a property is occupied under licence (e.g. hotel or employer-provided accommodation), this is not treated as an interest and is therefore disregarded for PPR purposes.

Taxpayers are often unaware that properties that they rent are treated in the same way as properties they own. If they only own one property but they rent another, they naturally expect the only residence they own to be their only residence for PPR purposes. By the time they become aware of the true position, typically after selling the property that they had owned, the deadline for making a PPR election to secure the relief has often passed. To avoid disadvantaging individuals in this situation, ESC D21 allows them to make a late election to get their affairs in order. Each residence, or each of them except one, must have "no more than a negligible capital value on the open market" (e.g. one freehold residence and one rented residence) and the individual must make the election within a reasonable time of becoming aware that it is possible.

The treatment of tenancies as eligible residences is a particular problem for individuals to whom the period of absence provisions ought to apply. Under the existing legislation, period of absence relief is not available where an individual has another residence which is eligible for PPR relief during the absence (s223(7) TCGA 1992). An individual who is put up by his employer during a period of absence can therefore qualify for the period of absence provisions relatively easily, as a licence is not an interest, but an individual who has to rent somewhere himself may have difficulty.

HMRC acknowledge this difficulty for tenants in their manual at CG65047 and by concession will allow an individual to make a PPR election in favour of the property from which he is absent. The purpose of this is to make the current residence ineligible for relief, thus allowing the period of absence rules to work as intended. In the current framework, the abolition of the PPR election would therefore significantly disadvantage individuals who have to rent a second residence due to working away from home.

There does not appear to be any good reason why shorthold tenancies should be treated as potentially eligible interests for PPR relief. It is counterintuitive and causes anomalies in the system, which then require correction via concessions. If the definition of a residence in s222 were amended to exclude such interests, this would simplify the relief and make it work in the way that most taxpayers would expect it to. This will be particularly important if the ability to elect is removed, but it should be considered in any event. The wording in ESC D21 regarding interests "of negligible capital value on the open market" could be borrowed for this purpose.

We assume that the government does not intend to make any changes to letting relief, as this is predicated on the availability of PPR relief in any event, but we would welcome confirmation on this point.

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

In our view, the administrative complexities of the two proposals set out in paragraph 3.5 of the consultation document means that neither method would be feasible in practice; either for taxpayers who would often need to collect and retain extensive records, sometimes for decades, or for HMRC who would need to devote additional time and resources to agreeing claims for PPR relief. The existing system has worked reasonably well for nearly 50 years and has saved time for taxpayers, practitioners and HMRC alike. The many cases which have reached the Tribunal in recent years relate mainly to whether a property owned was a residence rather than a main residence and so eligible for an election to be made. Determining the PPR on the basis of the facts is the existing position where no PPR election is made, and in our experience it is even more time consuming and administratively difficult for both HMRC and taxpayers to determine which of the properties available to an individual should be his or her main residence, throughout that individual's lifetime.

If PPR elections are abolished, the position for married couples/civil partners who spend significant periods apart (e.g. due to working in different cities) but are nevertheless "living together" would be particularly complex, as each member of the couple would need to consider his or her factual position/days of presence and the couple would then need to decide, on balance, which of the residences available to them should be their main residence. This is particularly complex in cases where several properties are owned and/or where work patterns or lifestyle factors change. This issue could be resolved by allowing spouses/civil partners to self-assess a PPR independently, but given the potential tax at stake if couples were able to have separate PPRs, we expect the government will not consider this to be a viable option. We have therefore proposed an alternative in our answer to question 12 below.

It should be noted that spouses/civil partners who are "living together" do not necessarily have the same residence status but they must nevertheless be deemed to have the same main residence. Typically this will arise where one spouse has been assigned to work full-time abroad and is non-UK resident under the third automatic overseas test but the other spouse has remained UK resident (e.g. more time spent in the UK in order to take care of children who are still in education). In those circumstances, it would not be unusual for the couple's factual main residence to be the UK home. We presume that HMRC accept that it is appropriate in these circumstances for the non-UK resident spouse to be treated as continuing to occupy the UK home as the main residence. We would welcome confirmation on this point.

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

We suggest that it should remain possible for all individuals to make a PPR election, but that election should only be effective for periods of UK residence. We are conscious that this may be discriminatory under EU law and therefore suggest two alternatives:

- Non-UK residents should be able to make an election to be regarded as UK resident for tax purposes, thus retaining the ability to make an effective PPR election in the same way as other UK residents but bringing worldwide residences into the scope of UK CGT (the interaction with double taxation treaties and proportionality under EU law would need to be considered);
- EEA residents should be eligible for PPR relief on a UK property that has been elected as the PPR. We do not have access to data which would enable us to calculate the tax at stake if residents of other EEA countries were eligible for PPR relief on UK properties, but suspect the tax cost of this may be modest.
- We are aware that the purchase/ownership of a property which is used as a residence might be within the remit of Free Movement of Capital and so, given that this Freedom applies to capital movements between Member States/EEA countries and third countries, discriminating against non-EEA residents may potentially breach EU law. We do however suggest that the government consider whether such restrictions may be justifiable. For example, national legislation in other contexts has previously been found to be compatible with EU law on the grounds that a government is seeking to meet the specific needs of all or part of its population (*Tankreederei I SA v Directeur de l'administration des contributions directes,* paras 30-32, C-287/10).

Please note, we have suggested that it should be possible for non-UK residents to make an election but for the election not to have effect for parts of the period during which the individual is non-UK resident, as individuals are often unable to confirm their residence position until after the end of the tax year, and an individual's residence status on a particular day may change depending on subsequent actions, such as days of presence, working hours and number of ties to the UK, which is particularly complex for internationally mobile individuals This would therefore represent the simplest position administratively.

If distinguishing between taxpayers on the basis of residence in the UK, EEA, or particular treaty countries is considered not to be an option, retaining the election but narrowing the scope of the residences to which it can apply could be considered. If the targeted properties are essentially UK holiday homes held by non-residents, a test based on a minimum occupation requirement might be viable if it is kept reasonably simple and is drafted carefully.

Under the second automatic UK test (the "only home" test) of the Statutory Residence Test (SRT), a UK or overseas home is disregarded if the individual has not been present at it at some point on at least 30 separate days in the tax year in question. A similar test could be put in place for PPR, whereby a residence is only eligible to be elected as the main residence if this 30 day test is met. For an individual who needs to consider his residence position, he is likely to already be keeping track of his occupation in the UK home, as meeting the 30 day threshold may have consequences under SRT in addition to presence in the UK in general. Individuals who only live in the UK are unlikely to be in the habit of keeping track of dates of their occupation of their different homes, but if the threshold is sufficiently low, the level of evidence required for the minimum threshold should be manageable and in most cases it would maintain the status quo for UK residents.

As in the "only home" part of the SRT, any minimum occupation test should be based on presence at any point in the day rather than a midnight. Midnight is practical for determining presence in a particular country, but is impractical in determining the occupation of a home, as the nature of people's working patterns and social lives will mean that they are not necessarily home by midnight on a given evening. Unlike the SRT test, the minimum occupation test would need to take into account married couples and civil partnerships. We would suggest doubling the chosen threshold but counting each spouse independently (e.g. an individual threshold of 30 would be doubled to a joint threshold of 60, but this could be satisfied by 60 days of presence by one spouse, 30 days by each or any other combination that adds up to 60).

A minimum occupation threshold should only be used in the context of determining whether it can be subject to an election. A residence that does not meet this threshold but is the only residence should still qualify as it does under the current rules, as there may be good reasons for the low occupation (e.g. due to hospitalisation of the taxpayer or looking after sick relatives). Similarly, if there is more than one residence and no election has been made, it should still be possible for a property with low occupation to attract relief if it is factually the main residence (i.e. preserving the current position where there is no election).

The availability of PPR relief to trustees is not specifically addressed in the consultation document but we comment that, in our view, a PPR election should remain available in these circumstances. Aside from the deemed final 18/36 month period of occupation, an individual is only able to have one PPR at a time. Where trustees own a property which is used by a beneficiary as a residence, if PPR is available to the trustees, the beneficiary is not able to qualify for PPR relief on an additional property he or she owns personally. Since PPR relief claims by trustees impact on the beneficiary's personal tax position, and as he or she may receive no benefit from PPR claims made by trustees (depending on the terms of the trust) it seems to us that it would be fairer for flexibility to remain in these circumstances.

Delivery mechanism

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

We understand from discussions in working groups with HMRC and HM Treasury that the government favour requiring payments on account, to be paid by the vendor on his or her own behalf, rather than lawyers/accountants etc. being required to collect withholding tax due and pay it to HMRC. We consider this to be sensible, given the difficulties with regard to which creditor should take priority (e.g. mortgage provider or HMRC), the potential for avoidance where large loan-to-value mortgages are taken out prior to disposal and, we understand, the inability of lawyers and certain other advisors to act where obligations cannot be fulfilled. We have therefore commented on a payment on account system instead of withholding tax.

If the government do further consider a withholding tax option, we would comment that it would not be appropriate for professional advisors to be responsible for the identification of the vendor as non-resident as it is not possible to assess residence status until after the end of the tax year in which the sale took place. In our view, if withholding is to be applied, it should be the default option unless the vendor obtains agreement from HMRC either that he will self-assess the tax due or no tax is due as the property qualified for PPR relief.

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

As noted in our answer to question 13 above, we understand that HMRC favour a payment on account mechanism, instead of withholding tax, and so we have commented on the collection of tax through payments on account in our answer to this question.

Payments on account to be paid by the vendor would appear to be a sensible option, though it will be difficult for the government to set an appropriate level of payment and sufficient time must be allowed for vendors to calculate and pay any payments on account due (timescales are considered in our answer to question 16). In order for payments on account to be viable, it must be possible for vendors to calculate the payment on account due without needing to collate significant information or obtain valuation reports. Methods for calculating payments on account are considered in our answer to question 15.

Before considering the practicalities around collecting payments on account, we have first considered whether payments on account should be collected in every instance. In our view, the following should not be required to make payments on account:

- Individuals and trustees who are eligible for PPR throughout the ownership period, such that no chargeable gain arises.
- Clearly the greatest risk of non-compliance arises from people who are leaving the UK tax net. We therefore suggest that non-residents who are purchasing another UK property or who will retain other UK assets (such as a rental portfolio against which HMRC could issue a charge in the case of non-compliance) should not be required to make payments on account. It should of course also be noted that individuals who are reinvesting in the UK property market may be restricted from doing so if a proportion of sale proceeds on the property they are selling must be paid to HMRC, and so requiring these persons to make payments on account could distort the property market.
- In other areas of tax, responsible taxpayers who are up to date with their returns and who have paid tax on time receive more favourable tax payment and administrative terms than taxpayers who make late returns or late payments (e.g. the non-resident landlord scheme). We suggest this principle should be extended to payment of CGT by non-residents. Thought would need to be given to taxpayers who are up to date on their tax affairs but do not have a self-assessment record (e.g. employees whose tax is collected through PAYE). The government may consider it preferable to remove such taxpayers from being required to make payments on account (possibly provided they submit a notice of liability), so as to avoid an influx of individuals filing tax returns in order to generate a self-assessment record.

If any of the above apply, the government could require that in exchange for not making a payment on account the vendor submit a simple form stating that PPR relief covers the full amount of gain or notifying a potential CGT liability and confirming the intention to file a self-assessment return and pay any CGT by the relevant deadline (though as per our comments in relation to withholding tax, we do not consider that it would be viable for tax advisors, solicitors or other advisors to be required to certify residence, as i) residence on a given date may be determined by subsequent events under the statutory residence test and ii) advisors may be unable to obtain sufficient evidence to provide such a certification). We say potential CGT liability, as vendors may not have sufficient information to determine whether a gain or loss arises at this time and, in principle, the usual self-assessment deadlines should apply – see our answer to question 16. We do however suggest that taxpayers who have good reason to believe themselves to be UK resident should not be penalised if it later transpires that they are non-UK resident and they have failed to submit the form.

Where necessary, the form could generate a self-assessment record/issuance of a tax return. Clearly under current legislation self-assessment returns may not be required where PPR relief is available throughout the ownership period such that no gain arises; the government could either include a tick box stating that no chargeable gain or loss arises due to the availability of PPR relief throughout the ownership period (or where any gain is within the annual exemption, where relevant). In such cases, HMRC may prefer not to request a tax return where a return would not otherwise be due.

If the government do produce such a form, it, or a link to it, could be included in a booklet to be handed out by lawyers and other advisors involved in the sale process. In addition, the booklet could provide guidance on how to calculate, disclose and settle payments on account

In cases where payments on account are due within 30 days, we suggest taxpayers should be able to file returns on paper or online, assuming a suitable online filing system can be established. In particular:

- If online forms are used, sufficient time must be allowed for vendors/their agents to register and for all required references (e.g. tax reference, payment reference, online registration key) to be available in good time for a self-assessment form to be submitted. In other areas of tax we find that this can take some weeks, in which case a longer time limit should apply and/or paper filing should be available.
- If online forms are to be used, it must be possible for self-assessment forms to be saved, so that both agents and taxpayers themselves have a record of what is submitted, and so that agents can send copies of the form to clients for approval pre-submission (unlike the online ATED-related gains forms, which cannot be saved);
- In correspondence from HMRC, we request that HMRC identify which client is being referred to (at present, when corresponding about both ATED and ATED-related gains, HMRC refuse to use client names for 'security reasons').

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

In our answer to this question, we have considered how to calculate payments on account. We have addressed reporting timescales in our answer to question 16.

In order for a 30 day time limit to be viable, it must be possible for the payments to be calculated in isolation, without needing to obtain valuation reports (e.g. of April 2015 values) or consider other income/gains/expenditure which would be required in order to calculate the gain. We therefore suggest that payments on account should be calculated based on a percentage of sale proceeds. There are three options for this:

1. A flat percentage. This would be the simplest option, but as the bluntest method would also result in some taxpayers who have not made a substantial profit being required to make high tax payments in comparison to the gain arising and others who have made large gains being required to make a low payment in relation to the tax due on the gain;
2. A flat percentage which changes depending on how long the property has been held, since (under current market conditions) gains are likely to be higher the longer a property has been held. Clearly if the property market were to fall, the rate of tax may need to be tapered over the short-term. For example, there could be a flat rate of 10%, which increases to 11% if a property has been held for more than a year, regardless of the actual gain (figures are purely illustrative); or;

3. A percentage which is adjusted based on regional variations in property values. This has the advantage of calculating a payment which is likely to most closely correlate to the CGT which will actually be due, but would be the most complex to calculate. If this option were pursued, HMRC could publish indexes based on changes in property values in particular regions and taxpayers could calculate the payment required using this index.

When deciding which option to pursue, the government would need to select a rate which is sufficiently high to motivate taxpayers to self-assess instead of simply making a payment on account, but not so high as to be wildly different from the tax actually due. The above three options increase in complexity (with option 3 being the most complex to calculate) but this complexity results in increased accuracy (with option 3 resulting in a figure which most closely correlates to the gain arising). If option 3 pursued an online calculator would be helpful (particularly for unrepresented taxpayers).

The government would also need to balance the need for accuracy with the administrative costs of compiling the index (e.g. where appropriate, the government could publish indices for a wide area, such as a grouping of counties with comparable property markets, rather than producing the postcode specific indices).

Question 16: Is it reasonable to ask non-residents to use self-assessment of a variant form to submit final computations within 30 days? If no, what processes would be preferable?

We consider that payments on account may be appropriate where there is a high-risk of non-compliance (e.g. taxpayers who regularly pay tax late or who are ceasing to have any liability to UK tax – see our answer to question 14) and 30 days may be an appropriate time limit for this (depending on how the collection system is administered).

30 days is insufficient time for taxpayers to self-assess their tax liabilities. Unlike stamp duty land tax, which is a relatively simple tax to calculate and report, being a fixed percentage of purchase price per acquisition, CGT is much more complex. In particular:

- Vendors may not know whether or not they are resident during a tax year until after the end of the tax year and, in the case of individuals, if split year applies they may become resident from a different date to the date of their arrival in the UK (or non-resident, as the case may be).
- If vendors need to calculate the increase in value of the property from April 2015 (see appendix 2), they may need to obtain a professional valuation report, which will take time to acquire.
- Taxpayers will need to determine the extent to which enhancement costs can be deducted when calculating the gain arising.
- Individuals who are, or may, be eligible, to pay 18% CGT will not be able to calculate their income until after the end of the tax year, (since they cannot be certain how much income will be received in the year until 5 April has passed and may need to wait for banks etc. to issue statements) and as such, will not be able to determine the rate of tax which they need to pay until after the end of the tax year.
- The available losses for the tax year may not yet be known.
- We do not yet know whether vendors will need to file online and obtain a new tax reference number when self-assessing CGT liabilities, but if so the time it takes for HMRC to issue tax and payment reference numbers, register people for online filing and authorise agents should be taken into account.

We suggest that the timescales for self-assessing liability to non-resident CGT should be aligned to the timescales for self-assessment generally, and appropriate changes could be made to existing self-assessment in order to enable persons within the scope of non-resident CGT to file one tax return (e.g. non-resident individuals could be required to complete the CGT pages accompanying the self-assessment tax return; a CGT section could be added to the income tax return completed by non-resident companies when paying income tax on UK source rental income, etc.)

We also request that, if ATED-related CGT is retained, it should be possible for both ATED-related CGT and non-resident CGT to be reported on the same self-assessment form, in order to reduce the administrative burden.

Appendix 2: Calculating gains and losses

Rate of tax

No questions were posed in the consultation document with regard to the rate of tax, but we have nonetheless commented on this. From reading the consultation document it is apparent that the government intend the taxation of non-residents to be comparable to the taxation of residents. However, it is unclear how this will be done, particularly in the context of companies and other entities currently within the scope of ATED-related CGT.

ATED-related CGT is (primarily) intended to apply where individuals indirectly own properties used as a home via an envelope. Given this context and the government's desire for people to de-envelope properties, we understand the government consider it equitable for the rate and calculation of ATED-related CGT and the CGT payable by individuals to be identical (albeit with PPR relief being unavailable to companies).

However, given that the current proposals concern 'fairness' and equality between UK and non-UK residents, it seems to us that this objective has been overridden. There are a number of reasons that non-UK residents may own properties, including use as homes/holiday homes, as part of a rental portfolio or for other commercial reasons. The types of entity used may vary depending on the use to which the property is put and commercial considerations, such as the need to limit liability. Ownership of properties by companies or other entities is not necessarily indicative of tax avoidance but is instead often made for sound commercial reasons.

Therefore, when deciding the 'fair' rate of tax, we suggest the government give careful consideration to how fairness should be judged. Why, for example, should a non-resident company with a rental portfolio be required to pay 28% CGT under the proposals, with no relief for inflation, whereas a UK resident company would pay 20% CGT and benefit from indexation allowance? From previous discussions with HM Treasury, we understand that the 28% CGT rate, which is lower than the 40%/45% income tax rate which higher or additional rate income taxpayers pay, is seen as 'fair' because the lower CGT rate provides some relief for inflation. We disagree: it seems to us that it would not be equitable for companies to be required to pay 8% additional tax on an indexed gain, and it does not seem to us to be proportionate under EU law.

We therefore suggest that non-UK resident companies should be subject to the same rate and basis of taxation as UK resident companies. In addition, given the changed government objectives, the principle of fairness and equity and the complexity that would arise from applying up to three types of tax to the same gain (corporate tax, ATED-related CGT and non-resident CGT) we strongly recommend that ATED-related CGT be abolished.

Gains accumulated up to April 2015

We understand that the government does not intend to subject to CGT gains accrued up to 6 April 2015 which are (or would be) taxable on non-residents. This is clearly equitable as non-residents who purchased a property before the policy to extend CGT to non-UK residents was announced in Autumn Statement 2013 entered in the UK property market understanding that any capital gains they realised would not be taxed. There seem to be three main alternative mechanisms to remove pre-April 2015 gains from the scope of non-resident CGT, which are:

1. Rebasing the value of the property to the value in April 2015.
2. Estimating the value of the property in April 2015 using an index.
3. Straight-line apportionment of the gain between pre and post April 2015 periods.

There are merits and drawbacks to all three options. Straight-line apportionment or a value based on an index would reduce the need for valuation reports to be obtained, which will be particularly relevant to disposals of properties at the lower end of the market, where obtaining a valuation report would be disproportionate to the gain arising. However, given the high-performance of the property market in recent years in certain areas of the UK (particularly London), some properties are now standing at a significant gain, with very large gains often being made over a short period. Applying a straight-line apportionment to these individuals could result in a very inequitable position, particularly if the rate of property growth slows (or falls) post April 2015, as a disproportionate amount of pre-April 2015 gain would be deemed to arise post-April 2015.

Whilst we acknowledge the simplicity of time apportionment, we consider that individuals should be able to elect that a property be revalued to market value in April 2015. This would also be consistent with previous changes to CGT impacting non-residents or non-UK domiciliaries, e.g. para 126, Schedule 7 FA 2008 and the 2013 ATED-related CGT rebasing. We suggest this election should be available on a property-by-property basis, so that taxpayers are able to make sensible decisions about whether or not to obtain valuation on a case-by-case basis.

A further complexity arises with regard to internationally mobile taxpayers; please see below.

Internationally mobile taxpayers

Scope of tax

Some taxpayers, particularly individuals, may move into and out of UK residence. We do not know whether, as matter of policy, the government intend to tax persons disposing of residence solely on the basis of where they are resident at the date of disposal or whether gains will be apportioned between resident and non-resident periods. Provided the taxation of residents and non-residents is aligned this should be irrelevant, but if taxation of residents and non-residents differs the position will be more complicated (see our comments above in relation to applying non-resident CGT to companies) and it may be necessary to apportion gains between residents and non-resident periods and apply the appropriate tax system.

Rebasing

The consultation document does not set out the government's intention with regard to taxation of individuals who are or have been UK resident at some point before April 2015 but who are non-UK resident on disposal of the property post April 2015. As non-residents are currently wholly outside of the scope of CGT on disposal of UK residential property regardless of where they were resident on acquisition or during ownership of the property, it seems logical for all gains realised by non-residents which are attributable to the period pre-6 April 2015 to be outside the scope of CGT, regardless of where they were previously resident.

Temporary non-residents

S10A TCGA 1992 applies to tax certain individuals who become non-UK resident and realise a chargeable gain on disposal of pre-departure assets while temporarily absent from the UK (which for departures post 5 April 2013 is defined as being for periods of absence of less than 5 years). Such individuals do not necessarily know whether or not they will return to the UK and, both due to this and in order to avoid complexity, we suggest non-resident CGT should apply as it normally would during periods of absence from the UK.

On return to the UK, if s10A applies, the post 2015 gain would already have been subject to non-resident CGT but the pre-April 2015 gain could be chargeable in the tax year of return. Therefore, we suggest s10A should not apply to gains realised on disposals of residential property where properties are acquired from April 2015.

As set out below, we suggest that relief should be available for non-resident CGT losses against any gains realised on disposal of UK residential property. As a result, the s10A pre-April 2015 gain chargeable in the year of return could be reduced by any brought-forward non-resident CGT loss.

We have not proposed that relief be available to reduce non-resident gains where there is a s10A loss on the same property, as this would be inconsistent with the operation of s10A. We instead suggest the s10A loss be available for offset against any gains within the scope of CGT in the year of return and/or gains of future years.

Losses

Paragraph 3.11 of the consultation document states that it will be possible to 'declare a loss' and specific consideration is given to losses which arise to companies, though no specific mention is made of the availability of losses to other non-residents.

We assume that losses will be available to all non-residents within the scope of non-resident CGT from April 2015, to the extent that any gain would be within the scope of CGT (i.e. we would not expect a non-resident to claim relief for a pre-April 2015 loss, as they would not pay CGT on any gain attributable to this period).

We have elsewhere in this response suggested that the government should abolish ATED-related CGT. If the government adopt this approach, clearly the government will need to allow some mechanism to allow relief for brought forward ATED-related losses. For example, the government could allow ATED-related losses to be offset against gains on disposal of any UK residential property.