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Mr A McGuiness
Specialist Personal Tax
Assets and Residence Policy
HM Revenue and Customs
100 Parliament Street
London SW1A 2BQ

20 June 2014

Dear Mr McGuiness

We refer to the Government consultation document entitled 'Implementing a capital gains tax charge on non-residents' and set out our responses to the questions posed by this document. For ease of reference, our responses are in the same order as the chapters in the consultation document.

1) Chapter 1 - Introduction

We note the Government's announcement that it will charge capital gains tax (CGT) on gains made by non-residents disposing of UK residential property from April 2015. It states that "the charge will come into effect in April 2015 and apply to gains arising from that date".

As this is a major change in the way the UK taxes offshore investors, it needs to be simple and give certainty, in order to be workable.

In light of the Government's stated aim that the charge is applied fairly, we believe that any element of pre-April 2015 gains should be excluded from the new regime. This would be similar to the approach taken for calculating any gains chargeable to UK CGT under the annual tax on enveloped dwellings (ATED) regime.

We understand that two main methods for the calculation of gains are being considered (the 2015 valuation method and the time apportionment method).

The time apportionment method appears to provide simplicity, however it would require historic records to be maintained giving the base cost of a property. If taxpayers have in the past had no other reason to maintain records, this information may not be readily available. The property may also have had significant capital expenditure applied to it. This is even more of an issue for individuals, who are not bound by corporate governance and the need to prepare accounts.

The time apportion method could also prejudice properties which have increased in value significantly before April 2015 due to, say, market increases, with a relatively slower increase post-2015. The intent of the new charge is to tax post-2015 gains. Thus an investor could be taxed on pre-2015 gains.

Using a valuation method would be consistent with the ATED gains regime. Although this would require yet another valuation date and could cause additional expense, it would provide a fairer basis for evaluating gains.

We therefore recommend that a '2015 valuation' method is used. To provide simplicity an election should be available to an investor to use a time apportionment method instead.

Consideration needs to be given as to when a building enters this regime. For example, a client who has recently acquired an office building which is let out for five years. In five years' time he may either re-let the building as an office or develop it into flats for rent which would continue to be held as an investment. What will be the base cost of the building when sold in say ten years time? Clearly any gain arising when the property was held as an office should be excluded as it is not a residential property. Additionally, it is arguable whether any increase in value attributable to the redevelopment element should be subject to CGT as it does not arise from a rise in value of residential property but rather from converting offices into property. We therefore recommend that the base cost for the proposed regime in such cases is the value on the date of practical completion of the development.

2) Chapter 2 - Key design features: who and what is in scope

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

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

An exclusion for communal use is appropriate to continue to encourage investment. Rather than limiting the exclusion to the three areas proposed, we recommend that a wider definition is used which encompasses all multi-occupation communal buildings.

The exclusion should also enable communal buildings occupied by key workers, such as doctors and nurses, to be excluded from the charge.

The 90% 'sole or main residence' test seems appropriate as it will reduce the risk of a building becoming tainted in error.

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

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

With respect to non-resident trustees, it is imperative that a property still qualifies for private residence relief (PRR) provided the beneficiary meets the new PRR rules (in whatever form they are introduced - see further comments below).

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 implementing a GDO test?

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Question 6: Are there any practical difficulties in implementing 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?

Using existing definitions for the GDO tests will maintain simplicity for funds in administering the new CGT charge.

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?

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?

We note the application of the new charge on non-resident corporate investors (NRCIs) still requires development. In particular:

- Loss offsets - NRCIs will be subject to UK income tax on their rental income and capital gains. UK companies have the ability to offset rental losses, management expenses and loan relationship deficits against capital gains. To be on a par with a UK company there needs to be flexibility to obtain these reliefs

- Group relief - UK companies can offset losses from one company to another. This is not currently the case with NRCIs

- Indexation - UK companies are entitled to indexation relief. This should also be available to NRCIs

- Tax rate - when this measure is introduced, the UK corporation tax rate will be 20%. It is appropriate that a similar rate is used, assuming that the reliefs mentioned above are available, or, if not a lower rate may be appropriate

- Group transaction - UK companies can transfer an asset to another group company under s171 TCGA 1992 without a taxable gain arising. Similar treatment should be available for transactions between two offshore group companies

We note that consideration is being given to taxing NRCIs either to CGT or to corporation tax. Some of our offshore clients are concerned that this measure could be the first step down a slippery slope. Subjecting NRCIs to CGT may reduce this concern as it is a targeted measure. It will also mean that rental income would continue to be assessed under income tax.

Applying CGT would also mean that the legislation can be maintained in a single act, ie TCGA 1992, rather than spread over TCGA 1992 and the Corporation Taxes Acts.

The rate of tax charged however could be linked (either directly or a percentage point below) to the corporation tax rate to maintain some parity with UK corporates.

The application of two different regimes to tax offshore companies would lead to complexity in cases where properties have had different uses over the period of ownership. For example, if a NRCI acquires a property in April 2016 and sells it in March 2020, having let it out for the first two years of ownership, the ATED CGT regime would apply to half the gain and the corporation tax regime to the balance. Cases where a property flips in and out of the ATED regime would be even more complex. Whilst we understand the policy rationale for charging a lower rate on genuine rental businesses than that applicable to corporate envelopes, we believe that the two rates should be applied under a single consolidated regime to promote simplicity.

3) Chapter 3 - Key design features: how the charge will be implemented

This section sets out our response in relation to question 10-16 and includes some general observations on PRR.

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

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?

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

The Government has proposed a removal of the ability for a person to elect a residence as his or her main residence.

We have major concerns over the removal of this election for PRR purposes. We therefore propose an alternative approach to determining an individual's main residence that should address these concerns:

- A qualitative test should apply if a taxpayer has more than one home and does not make an election. A number of balancing factors would be considered, such as location of family, council tax address, doctor/medical address, DVLA address, voting records, postal address, leisure time etc

- Taxpayers would retain the ability to make elections, (extended to non-UK resident individuals), provided that they spend a minimum amount of time in the property for each year they wish to elect the property to be their main residence (for example, 120 nights). Unlike the qualitative test, making the election would require record keeping in terms of occupation of the property and would ensure that properties which are clearly not an individual's main residence would not benefit from the exemption.

We understand that the Chartered Institute of Taxation will suggest that instead, an election can only be made in relation to properties within the UK. We support this suggestion but understand that it may contravene the principles of freedom of movement within the EU.

An alternative (if possible under the free movement of capital provisions) which would require only minimal change is to consider extending the current PRR relief to all EEA citizens and deny other non-residents the ability to elect at all.

Outside the framework of the proposed legislation, it is not clear how changes to the PRR rules will impact married couples and civil partners, who based on the facts may have two separate main residences.

If changes are made to these rules we recommend that transitional provisions are included to ensure that elections made before the commencement date continue to be valid.

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If changes are made to these rules we recommend that transitional provisions are included to ensure that elections made before the commencement date continue to be valid.

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.

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

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

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

One of our key observations is the complexity involved in determining an individual's or company's residence status for UK tax purposes. Whilst the statutory residence test provides a legislative basis for determining whether an individual is UK resident, the tests are not simple to apply and some factors, such as the number of days present in the UK in the tax year can only be applied retrospectively. Additionally, in some situations it is necessary to know an individual's history of residence in determining current year status which adds further complications. It is feasible that an individual's residence position could be determined incorrectly leading to further administrative burdens for both HMRC and lawyers/accountants.

The consultation document includes two suggestions for methods of collection - self assessment or withholding tax. We understand from recent working group meetings with HMRC that the withholding tax option is to be replaced with an option to make a payment on account within say, 30 days of a transaction, followed by the making of a new non-UK resident CGT return filing. This is because of the difficulties identified with either the buyer's or seller's solicitor acting as collecting agent.

Collection via self assessment (individual or corporate) is most effective in circumstances where the taxpayer is already engaged in the UK tax system. However it relies on voluntary filing; therefore it may be cumbersome and difficult to ensure compliance. There could be a considerable time lag between the sale of a residential property and the self-assessment return being filed which may exacerbate a lack of compliance. It also requires taxpayers to pay tax in a country where they do not necessarily have any other filing requirements, considerably after the transaction in question has taken place.

The payment on account followed by the submission of a non-resident CGT filing is the alternative option if the taxpayer is not registered under self-assessment. We understand that this would work as follows:

- Payment of any amount (responsibility of seller) 30 days after completion of the transaction which is either a set percentage of the tax or an amount based on an estimated computation. It is noted that applying a set penal percentage rate may deter people from making the non-resident CGT filing.
- Non-resident CGT filing (responsibility of seller) within a prescribed time limit (possibly in line with the SA deadlines) submitting a detailed CGT computation (taking into account losses, PRR relief etc) and making any balancing payment due by a specific date.

For completeness we make the following comments about the proposals for a withholding tax system:

- An ability to opt-out of the withholding tax regime in a similar manner to the opt out available under the non-resident landlords scheme would be welcome.

- Due to the difficulties in determining a taxpayer's residence status in some cases, it may not be clear whether withholding is required at the time of the transaction. We therefore suggest a 30 day time limit for making the withholding is introduced, in line with the time limit used for stamp duty land tax. However, the stamp duty calculation is more straightforward than a CGT calculation may be - depending on the facts - and so a longer time limit may be appropriate.

- If an individual is wrongly identified as UK resident for a tax year, withholding tax will not be applied; however he or she will also not fall under the requirement to return via self-assessment reducing the enforceability of the charge. How does the Government intend to deal with this scenario?

- It is not clear whether the withholding tax would be calculated with reference to the proceeds of the sale or the gain element of the sale. Confirmation is needed on this point. Cash flow problems may arise if it is based on the proceeds, but if based on the gain element, this would need to be calculated which may not be a straightforward calculation, especially when PRR is available.

General comments

We note that the proposed legislation removes the confidentiality that non-UK residents with no connection to the UK previously had.

Unlike ATED, the proposed legislation does not impose a minimum value that the charge will apply to. Consideration should be given to whether a de-minimis limit of tax at stake should apply to ensure the proposed changes are cost effective to apply and implement.

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